$2.50 a copy

Regulation

Sept/Oct 1977 AEI Journal on Government and Society

PUBLIC USE OF PRIVATE INTEREST

CHARLES L. SCHULTZE

Products Liability *Richard A. Epstein*

A Paradox of Regulated Trucking
Milton Kafoglis

Will Carter Put Out the Fire?
David Gergen

In Search of OSHA *Philip J. Harter*

Miles per Gallon · Tris · Belts, Buckles, and Bags · On Oil Spills · TVs and Executive Discretion · and Others

Also: **Readings of Particular Interest**

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

THE AMERICAN ENTERPRISE INSTITUTE FOR PUBLIC POLICY RESEARCH, founded in 1943, is a publicly supported, nonpartisan center for the study of national problems. Its purpose is to foster innovative research, analyze public policy proposals, develop practical options, and present diverse points of view. Areas of concentration are economics, law, government, and foreign policy. The views expressed in AEI's publications, including this journal, are those of the authors and do not necessarily reflect the views of the staff, advisory panels, officers or trustees of AEI.

COUNCIL OF ACADEMIC ADVISERS

Paul W. McCracken, *Chairman, Edmund Ezra Day University Professor of Business Administration, University of Michigan*

Kenneth W. Dam, *Harold J. and Marion F. Green Professor of Law, University of Chicago Law School*

Milton Friedman, *Paul Snowden Russell Distinguished Service Professor of Economics, University of Chicago; Nobel Laureate in Economic Science*

Donald C. Hellmann, *Professor of Political Science and Comparative and Foreign Area Studies, University of Washington*

D. Gale Johnson, *Eliakim Hastings Moore Distinguished Service Professor of Economics and Provost, University of Chicago*

Robert A. Nisbet, *Albert Schweitzer Professor of Humanities, Columbia University*

G. Warren Nutter, *Paul Goodloe McIntire Professor of Economics, University of Virginia*

Marina v. N. Whitman, *Distinguished Public Service Professor of Economics, University of Pittsburgh*

James Q. Wilson, *Professor of Government, Harvard University*

EXECUTIVE COMMITTEE

Herman J. Schmidt, *Chairman of the Board*
William J. Baroody, *President*
Charles T. Fisher III, *Treasurer*
Richard J. Farrell
Richard B. Madden
Richard D. Wood

William J. Baroody, Jr., *Executive Vice President*

Gary L. Jones, *Assistant to the President for Administration*
Edward Styles, *Director of Publications*

PROGRAM DIRECTORS

Russell Chapin, *Legislative Analysis*
Robert A. Goldwin, *Seminar Programs*
Robert B. Helms, *Health Policy Studies*
Thomas F. Johnson, *Economic Policy Studies*
Marvin H. Kosters, *Government Regulation Studies*
W. S. Moore, *Legal Policy Studies*
Rudolph G. Penner, *Tax Policy Studies*
Robert J. Pranger, *Foreign and Defense Policy Studies*

ADVISORY COUNCIL, CENTER FOR THE STUDY OF GOVERNMENT REGULATION

Irving Kristol (chairman), Robert H. Bork, Bill Brock, Ronald H. Coase, Kenneth Dam, John N. Erlenborn, Bryce N. Harlow, Robert H. Hatfield, Ernest F. Hollings, Max M. Kampelman, Lewis Lehrman, Richard Posner, Richardson Preyer, R. Randolph Richardson, William Ruckelshaus, George P. Shultz, Paul Weaver, Murray Weidenbaum, Aaron Wildavsky, and James Q. Wilson. Marvin H. Kosters (director) and James C. Miller III (co-director).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Regulation

Sept/Oct 1977 AEI Journal on Government and Society

Competition of ideas is fundamental to a free society

Publisher, *William J. Baroody, Jr.*

Editor, *Anne Brunsdale*

Board of Editors, *Irving Kristol, Robert Bork, Jeane Kirkpatrick, Marvin H. Kosters, James C. Miller III, Austin Ranney,* and *Antonin Scalia*

Associate Editor (PERSPECTIVES), *James C. Miller III*

Assistant Editor, *Sharon Shepherdson*

Contributing Editors, *Robert Helms, Marvin H. Kosters, Antonin Scalia, David Tuerck, Dan Larkins, Eugene W. Harper, Jr.*

Research Assistants, *Faith Breen* and *Douglas Ross*

Production Editor, *Donna Spitler*

Designer, *Pat Taylor*

Editorial Consultant, *W. S. Moore*

Interns, *Lorena Beer, K. C. Cerny, Thomas Gregg, Jennifer Highley, Craig Howell, Janice Pieroni,* and *George Vurdelja*

REGULATION, *September/October 1977, Vol. 1, No. 2. Published bimonthly by the American Enterprise Institute for Public Policy Research.* *Copyright 1977 American Enterprise Institute.* *Subscription rates: $12 for one year, $22 for two years (add $2 per year for foreign subscriptions). Single copy price, $2.50. Information on bulk orders or multiple subscriptions available on request. Editorial and business offices: c/o AEI, 1150 17th Street, N.W., Washington, D.C. 20036. Send changes of address and all subscription correspondence to Circulation Department, c/o AEI, same address.*

PERSPECTIVES on Current Developments 2

Oil Discharges and Oil Spills
Cargo Preference: A Foot in the Door?
The *Home Box Office* Case—A Summer Rerun
"Excess Gastric Acidity"?
Tris and Children's Sleepwear: A Two-Edged Sword
Belts, Buckles, and Bags
Miles per Gallon: Steps to 1985
TVs, Border Taxes, and Executive Discretion
Waterway User Charges and Balanced Transportation

OPINION: The Public Use of Private Interest 10
Charles L. Schultze

PRODUCTS LIABILITY: The Gathering Storm 15
Richard A. Epstein

WILL CARTER PUT OUT THE FIRE? 21
An Ambiguous Beginning
David Gergen

A PARADOX OF REGULATED TRUCKING: 27
Valuable Operating Rights in a "Competitive" Industry
Milton Kafoglis

IN SEARCH OF OSHA 33
Philip J. Harter

READINGS of Particular Interest 40

ISSN 0147-0590

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Perspectives
on current developments

Oil Discharges and Oil Spills

There may be general agreement among environmentalists and the oil industry on the need to keep oil out of the oceans, but there is controversy as well. At the center of the controversy are proposed U.S. Coast Guard regulations appearing in the *Federal Register* on May 16.

These regulations, which would be promulgated under authority conferred on the Coast Guard by the Port and Waterway Safety Act of 1972, would apply to all tankers of 20,000 or more dead-weight tons that use U.S. ports (almost all imported oil is transported in tankers of more than 20,000 dead-weight tons). They would require (1) that all such tankers—including those now in operation—be fitted (or retrofitted) with segregated ballast systems and (2) that all such tankers built in the future have double bottoms. A bill passed by the Senate in May (S. 682) is less demanding: it would require segregated ballast systems for such tankers built after June 30, 1983, and double bottoms for those built after June 30, 1979.

The segregated ballast proposal is aimed at curbing that portion of ocean oil discharge that comes not from accidents or groundings but from normal tanker operations (85 percent of total discharge or 1.8 million metric tons). In most tankers, cargo (crude oil) and ballast (seawater) use the same tanks, so that when seawater ballast is discharged, some oil goes with it and pollutes the ocean. Also, oil tends to stick to the sides of the cargo tanks and to form a kind of sludge in the bottom: to restore full capacity (the sludge can run into many tons) and, of course, to recover the full cargo for discharge, the tanks have to be washed down. This washing can be done either with sea water or with crude oil from other cargo tanks. Some operators merely discharge the oily sea water after washing down the tanks; most do not.

Clearly the use of a segregated ballast system would reduce the amount of oil discharged with the sea-water ballast. It would also mean that some of the tanker's capacity could not be used to transport oil. The American Petroleum Institute, which represents owners of two-thirds of the privately owned U.S.-flag tankers, estimates that if the Coast Guard proposal were to go into effect 20 percent of present capacity would be lost. According to API, the cost of replacing this capacity plus the cost of retrofitting could run as high as $12 billion. The Coast Guard, without taking the lost capacity into account, estimates the cost at $1.5 billion. In the API's view, an equal reduction in oil discharge could come through washing the cargo tanks with crude oil rather than sea water and returning the crude oil to the cargo. (However, only tankers with inert gas systems that permit carbon dioxide to be introduced into the cargo tanks can be safely washed with crude oil.)

The double-bottoms proposal is aimed at reducing the probability of oil spills from accidental groundings. The Coast Guard estimates that double bottoms would prevent oil-tank penetration and spillage in nearly half of all groundings that now occur. On the other hand, according to the API, since tankers with double bottoms ride lower in the water, they run aground more frequently and (when they are hauling cargo) they have to jettison more oil for reflotation; thus, the amount of oil spillage and discharge prevented could be less than half the Coast Guard's estimate.

The major point at issue appears to be the retrofitting of present tankers with segregated ballast and whether crude-oil washing can be substituted for that. The Sierra Club and the Environmental Defense Fund argue that the crude-oil washing proposal, while it would reduce oil discharge, would do nothing about the problem of oil discharged with ballast. API argues that crude-oil washing would reduce oil discharge significantly and that the retrofitting requirement would be inflationary, greatly increasing the present cost of imported oil.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Curiously, the alternative of establishing accident liabilities and large pollution fines, as suggested by the Council on Wage and Price Stability, is not being given serious consideration. According to CWPS, such a program would force tanker owners and operators to employ the least costly measures to reduce accidental oil spillage. They would then have the flexibility to use segregated ballast, crude-oil washing, improved crew training, or future innovations to reduce oil discharges.

Cargo Preference: A Foot in the Door?

President Carter has endorsed—and a House committee has approved—legislation that would ensure tankers built in the United States and flying the U.S. flag a minimum share of the U.S. oil-import market. The President's proposed standard—4.5 percent, rising in five years to 9.5 percent—is far lower than the 30 percent proposed by Chairman John Murphy (Democrat, New York) of the House Merchant Marine and Fisheries Committee and included in the energy transportation security bill of 1974 (vetoed by President Ford). But it is larger than the 3-to-4 percent currently being carried in the absence of a cargo preference requirement. Moreover, if enacted, it would represent a foot in the door for the maritime unions and the shipbuilding industry, which have long insisted that the defense, environmental, and job benefits of generous cargo preference more than justify the costs.

A sizable U.S.-flag fleet is needed, so the argument runs, because in wartime U.S.-owned ships operating under foreign flags might not be available for our use (that is, the registering country—Panama, for example—might prevent it). Also, U.S.-flag tankers and crews are alleged to be less accident prone than foreign-flag tankers and crews. Moreover, according to the Shipbuilding Council of America, the President's proposal would create some 10,000 new jobs in shipbuilding and 30,000 new jobs in related industries.

Critics of cargo preference argue that it would lead to higher prices for imported oil and to increased subsidy payments. (These payments are made because the construction and operation costs of domestic tankers are higher—currently about 200 percent higher—than those of foreign tankers.) The annual cost of Carter's proposal has been estimated at $110 million by the Maritime Administration and at $1 billion by the Federation of American Controlled Shipping (FACS). Using the Shipbuilding Council's figure of 40,000 jobs created and attributing all the cost to jobs, these estimates imply an annual cost per job created ranging from $2,750 to $25,000. The difference in the cost estimates may in part be attributable to the fact that, according to testimony by Assistant Secretary of Commerce for Maritime Affairs Robert J. Blackwell, the administration does not intend to pay construction differential subsidies or operating differential subsidies to tankers built to carry part of the guaranteed percentage of U.S. oil imports.

Prices for imported oil would be higher because of the additional transportation costs and the market effects associated with cargo preference. Estimates of the additional transportation cost for oil carried in cargo preference ships (in 1985) range from 1.3 cents per gallon to 2.8 cents per gallon (1977 prices). Most of the difference between the low (Maritime Administration) and the high (FACS) comes from alternative estimates of the cost of building tankers in the United States instead of acquiring new (or used) tankers abroad. As for market effects, the General Accounting Office predicts a 10-percent markup by U.S.-flag carriers owing to excess demand for U.S.-tanker tonnage, and puts the total transport price differential at between 1.6 and 2.4 cents per gallon of oil carried by cargo-preference tankers. On this basis, GAO concludes that the average price of all imported oil would rise by 0.2 cents per gallon, which would increase consumer costs by $240 million, assuming oil imports of 8 million barrels annually. However, if oil imports amounted to over 10 million barrels annually (which GAO predicts for 1988) and if domestic oil prices adjusted to the world level, consumer costs would come to $600 million a year—more than five times the figure estimated by the Maritime Administration.

There is also dispute about the defense and environmental benefits that cargo preference might bring. FACS, which is made up of the owners of U.S. ships operating under foreign flags, argues that the registering foreign governments have agreed to cede control of U.S.-owned foreign-flag vessels if the United

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

States charters or requisitions them. It points to prior Department of Defense testimony rejecting the notion that cargo preference legislation is essential to national security. On the other hand, Secretary of the Navy Graham Claytor has testified that "current U.S.-flag tonnage, by itself, is inadequate to satisfy both defense and commercial needs in event of war or national emergency." FACS also disputes the view that foreign-flag tankers have a higher accident rate than U.S.-flag tankers. While they have more accidents, they carry approximately thirty times as much oil.

Critics have also suggested that the proposed policy might hamper U.S. efforts to maintain liberal trade relations with other countries, and might even contravene treaties. Assistant Secretary Blackwell's testimony on this point was inconclusive.

Unless future evidence shows that these estimates are grossly high, it would appear that American society is being asked to pay a large price to increase employment in the U.S. shipping industry. The House of Representatives is expected to complete action on the proposal by late September and then the action will move to the Senate.

The Home Box Office Case: A Summer Rerun

A major aspect of the *Home Box Office* opinion (see our July/August issue) has been cast into doubt by another panel of the very court that rendered that opinion. In *Action for Children's Television* (ACT) v. *FCC*, decided by the United States Court of Appeals for the District of Columbia Circuit on July 1, 1977, ACT challenged the FCC's decision to leave the special problem of children's television to industry self-regulation for the time being and to reject mandatory requirements proposed by ACT. This decision had followed a closed-door meeting between the commission chairman and National Association of Broadcasters' officials in which, according to ACT, "the industry was . . . coerced" into adopting self-imposed restrictions on the length and character of advertising in children's programming. One of ACT's major contentions was that this ex parte contact (an off-the-record contact without opportunity for other parties to reply) invalidated the FCC's decision, pursuant to the principle enunciated in *Home Box Office*.

The court rejected this contention. It purported not to overrule *Home Box Office*, explaining that it was merely declining to apply that case's new ex parte prohibition "retroactively." In any event, the panel in *ACT* v. *FCC* made clear that it did not agree with the broad sweep of the *Home Box Office* decision and that it would limit the prohibition of ex parte contacts to rulemakings which involve "competing claims to a valuable privilege."

Since the new decision clearly disapproves the broad principle established by *Home Box Office* but does not explicitly overrule that case, it poses a nice problem for federal regulatory agencies and the parties involved in rulemakings before them: which of the two inconsistent opinions should be used as a guide for future action? The legal point may be resolved by the Supreme Court if it agrees to accept the *Home Box Office* appeal. It is also possible that the full bench of judges of the court of appeals will agree to resolve the conflict between their two panels in connection with a petition for rehearing in the ACT case. If the matter is not settled in one of these fashions, it may be difficult to frame a case that will present the issue: to do so, an agency would have to proceed in contravention of the *Home Box Office* principle, thereby running the risk of having its rulemaking invalidated. Until the matter is settled, it seems unlikely that ex parte contacts in informal rulemaking will be entertained.

"Excess Gastric Acidity"?

The Federal Trade Commission has concluded hearings on a trade regulation rule that would tightly circumscribe the claims that over-the-counter drug manufacturers may make on behalf of their products. The rule, which would limit OTC drug advertising to the exact words and phrases (no synonyms) approved by the Food and Drug Administration for use in labeling, would cover over 200,000 OTC brands currently being reviewed by the FDA in a series of twenty-seven monographs.

Proponents of the rule view OTC drug advertising as particularly likely to deceive—and harm—consumers. It is argued that consumers pay attention to advertising claims but ignore

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

labels and thus end up using drugs in ways that are dangerous or ineffective or both. In this view, the language commonly used by advertisers to promote OTC drugs distorts consumers' tastes by increasing the demand for drugs in general (as well as consumer dependence on drugs) and by leading consumers to buy one drug when another would offer better treatment at less risk.

An example of the practices that proponents aim to eliminate may be found in the television claims to the effect that a particular preparation "contains twice as much of the pain-killer doctors recommend most"—that is, twice as much as is contained in ordinary aspirin—or "contains a pain-killer recommended by doctors four-to-one over aspirin-substitutes." In each case, of course, the pain-killer is aspirin, as the label would reveal. The first claim means only that this preparation comes in larger or more concentrated tablets than ordinary aspirin while the second means that four out of five times doctors will recommend "take two aspirin" rather than "take two Tylenol."

Opponents of the FTC's proposal describe it as a meat-ax approach to the problem of disseminating accurate consumer information on a complex subject. The Council on Wage and Price Stability urges that the promulgation of the rule be postponed until a full cost/benefit analysis can be carried out—which cannot be done until more of the FDA monographs on permissible language for OTC drug labels are completed. At present one has been finished (on antacids), and twenty-six are still to come.

The council suggests that the rule might decrease the cost-effectiveness of self-medication (1) by restricting the dissemination of useful information, since standardized language would be required, and (2) by requiring the use of technical medical language (for example, "excess gastric acidity") rather than language consumers would readily understand ("indigestion from too much stomach acid"). The pre-selected standardized terms advertisers would have to use might thus confuse, rather than aid, consumers, causing them to shift from OTC drugs to inferior home remedies or to choose OTC drugs that do not match their conditions.

Moreover, the council suggests that the standardization of language, by reducing the effectiveness of advertising in conveying information or persuading consumers to buy, would reduce competition among the many similar drugs now in the OTC drug market (as when an aspirin compound is different from straight aspirin) and would retard the introduction of new drugs to replace or compete with the old—in both cases leading to higher prices.

If, as expected, the proposed rule is promulgated before the FDA completes its evaluation of the remaining twenty-six drug categories, regulators will have rushed in where even economists fear to tread. And, given the Supreme Court's recent extension of First Amendment protection to commercial advertising, constitutional challenges of the rule will be likely.

Tris and Children's Sleepwear: A Two-Edged Sword

The government's imposition of safety standards for children's sleepwear has had unforeseen consequences. Five years ago, textile manufacturers began using the flame retardant Tris-BP in children's sleepwear as the most economical way to meet federal flammability standards set by the Flammable Fabrics Act and the Hazardous Substances Act (as amended). On April 8 of this year, the Consumer Product Safety Commission, at the urging of the private Environmental Defense Fund, cited the Hazardous Substances Act in prohibiting any further use of Tris. National Cancer Institute laboratory tests had shown that rats exposed to Tris developed cancer.

The commission ordered apparel manufacturers to end their use of Tris and to repurchase all unwashed Tris-treated garments from retailers and consumers (washing greatly reduces the amount of Tris on the garment's surface). The American Apparel Manufacturers Association appealed the order in the U.S. District Court for the District of Columbia. Judge George L. Hart, Jr., found the repurchase order unlawful and held that the costs of repurchase should be spread among all parties having a hand in the manufacture of the Tris-treated garments—chemical companies, textile mills, and apparel manufacturers. Not long thereafter, on an appeal from Spring Mills, Inc., U.S. District Court Judge Robert Chapman, in

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Columbia, South Carolina, invalidated the Consumer Product Safety Commission order on the ground that the commission had not properly followed its own rules of procedure.

After the National Cancer Institute evidence came to light, manufacturers voluntarily ceased making garments from Tris-treated fabrics and most retailers ceased selling them. Unfortunately, though Tris is used in only 40 percent of children's sleepwear, there is no easy way of telling which 40 percent of the sleepwear now in the hands of retailers and consumers contains Tris, since garments are not so labeled. Moreover, there is increasing concern about Tris substitutes: tests suggest that at least one of them is mutagenic and therefore probably carcinogenic. Thus, if the CPSC's order stands, it looks as though the only children's sleepwear on the market next spring may be heavy cotton pajamas and blanket sleepers, items that do not have to be treated.

The AAMA has estimated that the CPSC order would require the repurchasing, transporting, and destruction of up to 32 million garments at a one-time cost of $150 million. Moreover, using more expensive substitutes for Tris might entail a 25-percent increase in the cost of children's sleepwear—some $60 million a year for the present 60 million garments selling yearly at an average price of $4.00. If the $150 million cost of recall were spread out over time (at a 10-percent discount rate), it would come to $15 million a year. Thus the total yearly cost for the ban on Tris would be $75 million.

National Cancer Institute tests indicate that Tris may enter children's systems—through skin absorption and through the common habit of "mouthing" sleepwear—in sufficient amounts to cause 6,000 cancers per year. The cost per cancer prevented by the ban would thus be $12,500. (Of course, this assumes that any Tris substitute will not be carcinogenic—probably a false assumption.)

The Tris episode, though maybe an extreme case, exemplifies a common regulatory dilemma. If the agency does not act (say, to protect children from the danger their sleepwear will catch fire), it will be blamed. But if it does act, it runs the risk of creating a new problem (for example, causing more deaths through cancer than through burning). Sometimes the regulator's risk can be thankless.

Belts, Buckles, and Bags

On July 1, Secretary of Transportation Brock Adams announced that all cars sold in the United States after 1983 must have "passive" (that is, automatic) passenger protection in the front seats—either a combination of lap belts and airbags that inflate on impact or a system of lap/shoulder belts that automatically fasten around the passenger as he or she gets into the car. Secretary Adams's decision will become final unless overridden by a joint resolution of Congress before October 19.

According to the Department of Transportation, *proper use* of current lap/shoulder belts would prevent some 16,300 auto fatalities and 231,000 injuries each year; but these figures have to be reduced to 6,300 and 86,000, respectively, because of the failure of an estimated 65 percent of car occupants to buckle up. It is this situation that has led to calls for mandatory passive restraints. Also according to DOT, a full front airbag system with lap belts would prevent between 12,100 and 13,500 fatalities and between 104,000 and 115,000 injuries, depending on whether the lap belt were used 20 percent or 40 percent of the time (for protection against other-than-frontal collisions, the lap belt must be worn). Passive belts, on the other hand, would save between 9,800 and 10,700 lives and avoid between 117,000 and 129,000 injuries, depending on whether 40 percent or only 30 percent of drivers disabled the system.

Current lap/shoulder belts (with buzzers) add about $80 to the price of an automobile. In comparison, passive belts would add about $105 per automobile, according to DOT, whereas airbag/lap belt systems would add $177—a figure that industry says is far too low. But, accepting DOT's figures and assuming further that the average cost of an injury is $3,100 (a rough, tentative estimate provided to us by DOT staff), we can conclude that airbags (with lap belts) would save between 5,800 and 7,200 more lives annually than lap/shoulder belt systems and would cost $970 million more, or between $122,236 and $157,621 per additional life saved. Passive belts would save between 3,500 and 4,400 more lives than lap/shoulder belts at a cost of $250 million, or between $26,523 and $43,971 per additional life saved.

Critics of the secretary's decision point to DOT figures showing that if laws requiring

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

the use of current lap/shoulder belts produced 70 percent compliance (the rate observed in countries that have such laws), some 5,200 additional fatalities and 123,000 additional injuries would be prevented annually at no increase in the price of automobiles. (This, of course, excludes the cost of enforcing the law and the cost the consumer perceives in buckling up. Critics also question certain of DOT's assumptions about the effectiveness of airbag systems.) They point out, for example, (1) that in the sixteen recorded tow-away accidents involving airbag-equipped cars, not one of the occupants had buckled up, (2) that in three of these accidents the bags had failed to inflate, and (3) that, because of the cost, many owners may not replace their airbags after inflation has occurred.

Getting consumer compliance with auto safety regulations is obviously a difficult and uncertain business—as the widespread negative reaction to the belt-interlock system has shown. Even proponents of passive restraints recognize the possibility that Congress will veto the secretary's decision, and many of them oppose making such restraints mandatory, at least until additional evidence becomes available to bolster consumer acceptance. In light of the fairly certain costs of passive restraints and the uncertainties about their benefits, resistance to the standard and interest in the lower cost alternative of a mandatory seat-belt law can be expected.

Miles per Gallon: Steps to 1985

Rumor has it that cars produced in 1985 will be a lot better than cars produced now. They will be more streamlined and they will weigh less. They will have better automatic transmissions. Although they will not accelerate as well, they will have less aerodynamic drag, less rolling resistance, and better lubrication. The spark-ignition system will be more efficient, and there may even be new kinds of engines. On average, they will get more than 27 miles per gallon of fuel. At least, all this will come about if the domestic auto industry is to meet the fuel economy standards laid down by Secretary of Transportation Brock Adams on June 26.

In a 1975 amendment to the Motor Vehicle Information and Cost Savings Act, Congress established fuel economy standards for passenger automobiles of 6,000 pounds or less. The standards set were 18, 19, and 20 miles per gallon for model years 1978, 1979, and 1980 respectively, and 27.5 mpg for 1985 and after, with the secretary of transportation to announce standards for 1981-1984 no later than July 1, 1977. Operating under requirements that the standards reflect the "maximum feasible average fuel economy level" and make "steady progress" towards the 1985 goal, the National Highway Traffic Safety Administration asked everyone from consumer groups to foreign automobile manufacturers to submit information and argument relevant to these objectives. The focal point for the discussion (or most of it) was not *whether,* but *how rapidly,* the 1985 standards could be met. The answer came out at 22 mpg for 1981, 24 for 1982, 26 for 1983, and 27 for 1984.

The analysis released by NHTSA paints a rosy picture of the benefits these standards will bring in consumer savings, jobs, and energy conservation. Although the retail price of the average car will have risen by at least $175 (constant dollars) by 1984, the total consumer costs over the lifetime of the car should have declined by $450 (constant dollars). In other words, decreased maintenance costs (from the use of lightweight noncorrosive materials) and lower fuel costs should more than offset the expected rise in the initial retail price caused by design changes needed to meet the standards. As for jobs, NHTSA expects the fuel economy measures to expand the capital outlay of the domestic automobile industry by $3 billion over "business-as-usual" investments for the years 1981-1984—increasing industry jobs by 77,000, chiefly by stimulating production of such lightweight materials as aluminum and plastics. NHTSA also expects that these job gains will more than offset job losses from a predicted 150,000-unit drop in sales over that period. Finally, and central to NHTSA's analysis, oil savings over the average lifetime of the new cars are estimated at 1.2 billion barrels.

Auto manufacturers have expressed concern that the new standards could produce a severe slump in sales. Consumers, they say, will tend to discount the savings that NHTSA alleges will occur. Moreover, the standards will require radical style changes—something the public has not responded to favorably in

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

the past. Also, the auto companies fear that the shift to smaller cars will mean that those customers needing larger cars will turn to the used-car market.

Even more disturbing to the auto industry—both domestic and foreign—are the uncertainties about future emission and safety standards. Because these standards have a heavy impact on fuel consumption, uncertainty makes it difficult if not impossible to project fuel economy levels with great accuracy. Congress recently eased the 1978 emission standards so that the 1978 model cars already produced could be sold legally, and the future of the new safety standards is in doubt) see discussion of Secretary Adams's decision requiring passive restraints, page 6, this issue). Engines now being considered for the early 1980s—especially the diesel engines—may not be able to meet the future emission levels embodied in the Clean Air Act Amendments of 1977 without sacrificing fuel economy. If this should be the case, new engine technologies might have to be pursued, adding to costs.

There are other relevant issues that NHTSA did not consider—costs to the six-person family that might not be able to buy as large a car in 1985 and costs to those who prefer more steel and less plastic in their cars. It is difficult to estimate costs of this sort, but they exist and it would surely have added credence to NHTSA's analysis if they had been addressed.

The traditional policy response to increasing scarcity of any commodity is to let the market ration off the available supply. This appears to be politically infeasible in the case of oil and oil products. Proposals to levy a gasoline tax (to reflect the opportunity costs of fuel) have been greeted with strong protest. Still, it appears that we must pay one way or another. The path taken suggests we are more willing to bear the costs through higher auto prices than through higher prices paid at the pump.

TVs, Border Taxes, and Executive Discretion

In a July 28 decision (*U.S.* v. *Zenith Radio Corporation, 1977*), the U.S. Court of Customs and Patent Appeals upheld the discretionary power of the executive branch over border tax adjustments. Under the U.S. Tariff Act, the Treasury Department is required to impose a duty on imports to offset bounties or grants paid to exporters by their countries. Reversing a lower court decision, the appellate court found that Japan's refunding of its excise tax on electronic products when exported did not constitute a "bounty" or "grant" within the meaning of the Tariff Act and therefore did not require a countervailing duty (one equal to the net amount of the tax refunded). The decision was a victory for the U.S. Treasury. It not only upheld Treasury's long-standing administrative practice, but also, for a time at least, obviated the need for what reportedly had been the Carter administration's intended response to the earlier adverse decision—a request that Congress clarify the Treasury's discretionary authority in this area.

Although the facts of the case are simple, the implications are complex. Japan imposes a tax on the manufacture and sale of certain electronic products, including TVs and radios. This tax, which ranges from 5 percent to 40 percent, is similar to the value-added tax (VAT) imposed by most countries in Western Europe. As with VAT, Japan's tax is refunded to the manufacturer when the product is exported. Therein lies the problem: it has been U.S. trade policy to resist attempts by foreign governments to subsidize exports to this country.

In 1970, Zenith Radio Corporation asked the Treasury to rule that this refund constituted a bounty or grant. In January 1976, however, the Treasury ruled against Zenith, and that corporation, taking advantage of the 1974 amendment to the Tariff Act that gave U.S. firms the right to seek judicial review, contested the ruling in U.S. Customs Court. In April 1977, a special three-judge panel reversed the Treasury, but on appeal, the Customs Court was itself reversed, and Zenith said it would appeal to the U.S. Supreme Court.

The *Zenith* case has attracted considerable attention because it raises the question of the compatibility of American law with the system of border tax adjustments generally sanctioned by the major trading nations through the General Agreement on Tariffs and Trade (GATT). This system seeks to resolve the clash in international trade between two different principles of taxation—the corporate income tax, predominant in the United States and Canada, and the VAT concept, predominant in Western Europe and Japan.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Under GATT, border tax adjustments are permitted only for *indirect* taxes, such as VAT and excise or sales taxes, and not for *direct* taxes, such as corporate income taxes. The basis for this distinction is the belief, now widely challenged by economists, that indirect taxes are borne by consumers in higher prices, whereas direct taxes are borne by producers out of profits. Economists argue that the question of who bears the burden of taxation depends not so much on the type of tax as upon how production and consumption respond to changes in price.

As the Court of Customs and Patent Appeals saw it, that difficult question did not have to be resolved in the *Zenith* case. Rather, the sole issue presented was whether the Treasury had the authority to define "bounty" and "grant." In ruling that the refund of a commodity tax is not, as a matter of law, a bounty or grant within the meaning of the Tariff Act, the court relied upon the Treasury's nearly eighty-year practice of applying this provision only to an "excessive" refund—that is, one that *exceeds* the tax paid. Also, the court noted that Congress had implicitly recognized the Treasury's practice—*and the secretary's authority to change it*—in other laws.

The italicized point is important. The *Zenith* decision, in addition to preserving executive policy-making in the complex field of border tax adjustments, removed an immediate threat to trade-liberalization negotiations in Geneva and to continued U.S. participation in the GATT system. Robert Strauss, U.S. special trade negotiator, said he was "very pleased."

Waterway User Charges and Balanced Transportation

Replacement of Locks and Dam 26 (located at Alton, Illinois) has been the subject of some controversy between environmentalists and Mississippi barge operators—but a Senate bill to fund the project has aroused a second controversy that overshadows the first. That bill tied this project, popular with Congress, to an unpopular provision requiring that, in ten years, commercial waterway users pay fees equal to *all* the operation and maintenance costs and *half* the construction costs of U.S. inland and intracoastal waterways.

Passed by the Senate on June 22 by a vote of 81 to 9, the bill died because of the constitutional requirement that revenue bills originate in the House of Representatives. And the House appears unenthusiastic about full user charges. H.R. 8309 (which also provides funds for Locks and Dam 26) would merely impose a tax on barge diesel fuel of four cents a gallon (the amount currently paid by truckers) in 1979 and six cents a gallon by 1981. A tax of six cents is only 14 percent of the estimated forty-cent tax needed to recover all operation and maintenance costs and half the construction costs.

User charges for inland waterways have always been a contentious issue in discussions of transportation policy. The barge operators obviously like the current system of no user charges, whereas the railroads (which own and therefore pay the costs of maintaining their tracks and rights-of-way) and the truckers (which pay federal taxes on fuel) want the system changed. Also, important questions of regulation hinge on the issue. For example, user charges would cause barge rates to rise, shifting some traffic to rail and truck.

The point at issue is efficient balance among the different forms of transportation. The most efficient use of resources occurs when the marginal cost of using each resource is equal to the marginal benefit that resource produces. When one form of transportation is subsidized, the true marginal cost of using that service tends to exceed the price users actually pay, and thus excessive amounts are used. Because the operation, maintenance, rehabilitation, and construction costs of waterways are highly subsidized by the federal government (at about $1 billion a year, reports the U.S. Department of Transportation), the cost of shipping commodities by barge is below real cost. Consequently, some shipments go by barge that could go more efficiently by rail or even truck. Of course, it may be argued that railroads and trucking are also subsidized. But trucks pay close to their full share of highway expenses through fuel taxes, according to studies by the Federal Highway Administration, and much of the federal support given to the railroads in recent years—for example, $2.1 billion to ConRail—is in the form of loans that are to be repaid.

User charges to barge operators could be expected to lead to a more efficient transpor-

(Continues on page 39)

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Opinion

Charles L. Schultze

The Public Use of Private Interest

In 1929, some 9 percent of the gross national income was spent by federal, state, and local governments for purposes other than national defense and foreign affairs. Between 1929 and 1960, however, the proportion of gross national income spent for domestic programs rose to 17.5 percent. Today, only sixteen years later, that figure is 28 percent.

The growth of federal regulatory activities has been even more striking. There is no good way to quantify regulatory growth, but a few figures will illustrate its speed. Even as late as the middle 1950s, the federal government had a major regulatory responsibility in only four areas: antitrust, financial institutions, transportation, and communications. In 1976 eighty-three federal agencies were engaged in regulating some aspect of private activity.

Even more relevant to my theme is the changing nature of government intervention. Addressed to much more intricate and difficult objectives, the newer programs are different; and the older ones have taken on more ambitious goals. In the field of energy and the environment the generally accepted objectives of national policy imply a staggeringly complex and interlocking set of actions, directly affecting the production and consumption decisions of every citizen and every business firm.

In a society that relies on private enterprise and market incentives to carry out most productive activity, the problem of intervention is a real one. After the decision to intervene has been taken, there remains a critical choice to be made: should intervention be carried out by grafting a specific command-and-control module—a regulatory apparatus—onto the system of private enterprise, or by modifying the informational flow, institutional structure, or incentive pattern of that private system? Neither approach is appropriate to every situation. But our political system almost always chooses the command-and-control response, regardless of whether that response fits the problem.

Once a political battle to intervene has been won in some broad area—environmental control, reduction of industrial accidents, or standards for nursing homes and day-care centers—the extent and scope of the resulting social controls are seldom grounded in an analysis of where and to what extent the private market has failed to meet acceptable standards. Similarly, there is seldom any attempt to design techniques of intervention that preserve some of the virtues of the free market.

Virtues of the Market

We acknowledge the power of economic incentives to foster steadily improving efficiency, and we employ it to bring us whitewall tires, cosmetics, and television sets. But for something really important like education, we eschew incentives. We would laugh if someone suggested that the best way to reduce labor input per unit of production was to set up a government agency to specify labor input in

Charles L. Schultze is currently the chairman of the Council of Economic Advisers. He was formerly a senior fellow in the Brookings Economic Studies program and professor of economics at the University of Maryland. Mr. Schultze also served as budget director in the Johnson administration.

©1977 The Brookings Institution. Adapted from Charles L. Schultze, *The Public Use of Private Interest* (Washington, D.C.: Brookings Institution, 1977); this material was originally presented in the Godkin Lectures delivered at Harvard University, December 1976.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

detail for each industry. But that is precisely how we go about trying to reduce environmental damage and industrial accidents.

The buyer-seller relationships of the marketplace have substantial advantages as a form of social organization. In the first place, relationships in the market are a form of unanimous-consent arrangement. When dealing with each other in a buy-sell transaction, individuals can act voluntarily on the basis of mutual advantage. Organizing large-scale social activity through the alternative open to a free society—democratic majoritarian politics—necessarily implies some minority that disapproves of each particular decision. To urge that the principle of voluntary decision should be given weight is not to make it the sole criterion. But precisely because the legitimate occasions for social intervention will increase as time goes on, preserving and expanding the role of choice take on added importance.

A second advantage of the market as an organizing principle for social activity is that it reduces the need for hard-to-get information. The more complicated and extensive the social intervention, and the more it seeks to alter individual behavior, the more difficult it becomes to accumulate the necessary information at a central level. Obviously, one does not rush out, on the basis of informational economies alone, and recommend, for example, that simple effluent charges displace all pollution-control regulations. But, where feasible, building some freedom of choice into social programs does offer advantages, either in generating explicit information for policy-makers about the desirability of alternative outcomes or in bypassing the need for certain types of information altogether.

A third advantage of the market is its "devil take the hindmost" approach to questions of individual equity. At first blush this is an outrageous statement and, obviously, I have stated the point in a way designed more to catch the eye than to be precise. To elaborate, in any except a completely stagnant society, an efficient use of resources means constant change. From the standpoint of static efficiency, the more completely and rapidly the economy shifts to meet changes in consumer tastes, production technologies, resource availability, and locational advantages, the greater the efficiency. From a dynamic standpoint, the greater the advances in technology and the faster they are adopted, the greater the efficiency. While these changes on balance generate gains for society in the form of higher living standards, almost every one of them deprives some firms and individuals of income. Under the social arrangements of the private market, those who may suffer losses are not usually able to stand in the way of change.

Dealing with the problem of losses is one of the stickiest social issues. There is absolutely nothing in either economic or political theory to argue that efficiency considerations should always take precedence. And sometimes there is no way to avoid unconscionably large losses to some group except by avoiding or at least moderating changes otherwise called for by efficiency considerations. Nevertheless, in designing instruments for collective intervention that will avoid loss, we place far too much stress on eschewing efficient solutions, and far too little on compensation and general income-redistribution measures. Over time, the cumulative consequences are likely to be a much smaller pie for everyone.

The final virtue of market-like arrangements that I wish to stress is their potential ability to direct innovation into socially desirable directions. While the formal economic theory of the market emphasizes its ability to get the most out of existing resources and technology, what is far more important is its apparent capacity to stimulate and take advantage of advancing technology. Living standards in modern Western countries are, by orders of magnitude, superior to those of the early seventeenth century. Had the triumph of the market meant only a more efficient use of the technologies and resources then available, the gains in living standards would have been minuscule by comparison. What made the difference was the stimulation and harnessing of new technologies and resources.

From a long-range standpoint, the effectiveness of social intervention in a number of important areas depends critically on heeding this lesson. Much of the economic literature on pollution control, for example, stresses the role of economic incentives to achieve static efficiency in control measures—that is, the use of existing technology in a way that reaches environmental goals at least cost. In the long run, however, the future of society is going to hinge on the discovery and adoption of ever-improving technologies to reduce the environmental con-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

sequences of expanding production. If, for example, we assume that per capita living standards in the United States improve from now on at only one-half the rate of the past century, the gross national product a hundred years from now will still have risen more than threefold. Median family income, now about $14,000, will equal about $55,000. Only if the amount of pollution per unit of output is cut by two-thirds can we maintain current environmental performance, let alone improve it—even on the assumption that the rate of economic growth is halved. There is simply no way such reductions can be achieved unless the direction of technological change is shifted to minimize pollution.

The point is not that the unfettered market can deal with the problem of environmental quality—or other problems for which some form of regulation already exists. Indeed, the problems arise precisely because the market as it is now structured does not work well. But the historically demonstrated power of market-like incentives warrants every effort to install such incentives in our programs of social intervention.

The Causes of Market Failure

Within the sphere of activities not excluded from the market by considerations of liberty and dignity, there remain many situations in which private enterprise operating in a free market as we now know it does not produce efficient results. Where the deviations are serious, a prima facie case arises for collective intervention on grounds of efficiency alone.

Every modern society is based upon a set of property and contract laws that specify a highly complex set of does and don'ts with respect to owning, using, buying, and selling property. The structure of the private enterprise system and the efficiency with which it operates depend on the content of this system of laws. How efficiently that system works at any point in time is strongly conditioned by how well it matches the underlying technological and economic realities.

A second basic proposition underlies an identification and analysis of market failure: to be an efficient instrument for society a private market must be so organized that buyers and sellers realize *all* the benefits and pay *all* the costs of each transaction. In other words, the price paid by the buyer and the costs incurred by the seller in each private transaction must reflect the full value and the full cost of that transaction not only to them, but to society as a whole.

As a rough-and-ready generalization, the body of laws governing property rights and liabilities is likely to yield inefficient results principally when dealing with the side effects of private market transactions. The problem is not that side effects exist, but that the benefits they confer or the costs they impose are often not reflected in the prices and costs that guide private decisions.

Where side effects are confined to the parties to a transaction, proper specification of the laws governing private property can sometimes ensure that they are properly reflected in the private accounting of costs and benefits. Under these circumstances, establishing some continuing mechanism of social intervention is unnecessary. Individual buy-and-sell arrangements can efficiently reflect social values. In many cases, however, the very nature of the situation is such that merely redefining property rights will not resolve the problem; markets can be organized by purely private efforts only at great cost, if at all.

There are essentially four sets of factors that lead to market failure: high transaction costs, large uncertainty, high information costs, and, finally, what economists call the "free rider" problem.

Transaction costs. Markets are not costless. There are expenses of money, time, and effort in setting and collecting prices. Sometimes transaction costs are virtually infinite: there is no conceivable way that a market can be formed to deal with side effects. Sometimes transaction costs, while not infinite, exceed the benefits that a market could otherwise confer, and so it does not pay to set one up. Very often the scope and nature of the transaction costs strongly limit the range of effective social intervention and force society to organize markets in less than an ideal way.

Uncertainty and information costs. It is easier to treat the problems of uncertainty and information costs together since it is through information that we can, at least sometimes, reduce uncertainty. Market transactions cannot be an efficient method of organizing human activity unless both the buyer and the sell-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

er understand the full costs and benefits to them of the transactions they undertake, including any side effects that impinge on their own welfare.

However, in the case of hazards that are highly complicated, the provision of technically complete but neutral information may not be very helpful. Evaluating the significance of such hazards may itself require more technical ability and judgment and more time than it is reasonable to expect from most consumers. Where the potential harms from a product feature are serious and where the technical difficulty of evaluating information is very great, regulation may be the best alternative despite its inefficiencies—and in some cases a ban on certain types of products may be required. But in all cases the comparison should be between an imperfect market and an imperfect regulatory scheme, not some ideal abstraction.

The "free rider" problem. Where the side effects of private transactions have a common impact on many people—for example, in the discharge of sulfur into the atmosphere from coal-burning utilities—the possibility of purely private action is severely limited. In theory, if the rights to the use of the clean air were assigned by law to the polluter, those affected might band together and pay the polluter to reduce the emissions. But any one individual would enjoy the benefits of the improvement whether he paid his share of the cost or not. He could be a "free rider" on the efforts of everyone else. How could cost shares be decided and enforced? Without the coercive power of government, purely voluntary arrangements could not be successful.

Changing Attitudes

Relying on regulations rather than economic incentives to deal with highly complex areas of behavior, as we do for control of air and water pollution and industrial health and safety, has a built-in dynamic that inevitably broadens the scope of the regulations. Under an incentive-oriented approach—effluent charges, injury-rate taxes, or improved workmen's compensation—the administering agency does not itself have to keep abreast of every new development. The incentives provide a general penalty against unwanted actions. But if specific regulations are the only bar to prevent social damages, the regulating agency must provide a regulation for every possible occasion and circumstance. First it will take twenty-one pages to deal with ladders and then even more as time goes on. Social intervention becomes a race between the ingenuity of the regulatee and the loophole closing of the regulator, with a continuing expansion in the volume of regulations as the outcome.

Relying on regulations rather than economic incentives to deal with highly complex areas of behavior . . . has a built-in dynamic that inevitably broadens the scope of the regulations. . . . Social intervention becomes a race between the ingenuity of the regulatee and the loophole closing of the regulator, with a continuing expansion in the volume of regulations as the outcome.

We try to specify in minute detail the particular actions that generate social efficiency and then command their performance. But in certain complex areas of human behavior, neither our imagination nor our commands are up to the task. Consistently, where social problems arise because of distorted private incentives, we try to impose a solution without remedying the incentive structure. And equally consistently, the power of that structure defeats us.

Market-like instruments can supplant current command-and-control techniques only gradually. But not much thought has been devoted to dynamic strategies that, step by step, mesh a dwindling reliance on regulations with a cautiously expanding use of market instruments.

When social intervention into new areas is considered, we start with a more or less clean blackboard. We do not have to erase an existing maze of command-and-control laws. But a different kind of problem then confronts us—impatience. Major political initiatives come only after the public has been persuaded that an important problem exists. A sense of urgency has developed. How can politicians then put before the public a ten-year plan for gradually developing a new market structure? Instead, the inevitable strategy is to enact ambitious legis-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

lation stipulating sharp and immediate results, and then to erode the regulations piecemeal with postponements and loopholes as problems develop. The very rhetoric and political process that moves us finally to get something done often puts us in a position where that something is done poorly.

The American political system has been a marvelously effective tool for providing both freedom and governance. Its institutions have been well suited for generating the compromises and accommodations about national issues needed in a large and heterogeneous society. But those institutions were especially designed to settle conflicts of value. As society has intervened in ever more complicated areas, however, and particularly as it aims to influence the decisions of millions of individuals and business firms, the critical choices have a much lower ideological and ethical content. For economic or social reasons, we may still want to move some area of decision-making completely out of the market and into the sphere of specified rights and duties. And the necessity will remain to form political battle lines around the very real question of whether to intervene at all. We cannot abandon the standard techniques and institutions for forming consensus and negotiating compromises among groups with widely different values.

But how does an ingrained political process which stresses value adjustments come to grips with the critical choices among technically complicated alternatives when some of the very political techniques that move society toward a decision themselves make it difficult to pursue workable methods of intervention? Identifying heroes and villains, imputing values to technical choices, stressing the urgency of every problem, promising speedy results, and offering easily understandable solutions which specify outputs and rights—these are the common techniques of the political process whereby consensus is formed and action taken.

There is no obvious resolution to this dilemma. The suggestion that the political debate be confined to ends, while technicians and experts design the means once the ends have been decided, is facile and naive. Ends and means cannot and should not be separated. In the real world they are inextricably joined: we formulate our ends only as we debate the means of satisfying them. No electorate or politician can afford to turn over the crucial question of how social intervention is to be designed to supposedly apolitical experts.

The only available course is a steady maturing of both the electorate and political leaders. How to intervene, when we choose to do so, is ultimately a political issue. I am convinced that the economic and social forces that flow from growth and affluence will continue to throw up problems and attitudes that call for intervention of a very complex order. How we handle those questions not only will determine our success in meeting particular problems, but cumulatively will strongly influence the political and social fabric of our society. Even if it were politically possible—which it is not—we cannot handle the dilemma by abjuring any further extension of interventionist policies. But, equally, we cannot afford to go on imposing command-and-control solutions over an ever-widening sphere of social and economic activity.

I believe—I have no choice but to believe—that the American people can deal intelligently with issues painted in hues more subtle than black and white. Indeed, the political winds of the last few years can be read as a sign that the electorate is somewhat ahead of many of its political leaders. Voters are not disillusioned with government per se. But they are fed up with simple answers to complicated problems. They are ready, I think, for a more realistic political dialogue. Almost two centuries ago the arguments for the ratification of the Constitution were laid out in *The Federalist* papers—perhaps the most sophisticated effort at political pamphleteering in history. I have good reason to hope—and to believe—that voters can accept the same high level of political argument as the farmers, mechanics, and politicians of the eighteenth-century colonies. ■

Ends and means cannot and should not be separated. In the real world they are inextricably joined: we formulate our ends only as we debate the means of satisfying them. No electorate or politician can afford to turn over the crucial question of how social intervention is to be designed to supposedly apolitical experts.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Products Liability: The Gathering Storm

Richard A. Epstein

In APRIL 1976, Congress authorized the expenditure of $135 million for a mass immunization program against the swine flu. Immediately thereafter, the Department of Health, Education and Welfare (HEW) sought to make contracts with several pharmaceutical firms for the delivery of large quantities of the vaccine by mid-summer. The effort quickly became snagged when the pharmaceutical firms found themselves unable to obtain comprehensive liability insurance. At issue was the threat of lawsuits brought by persons who would claim, not that the vaccine had failed to conform to HEW specifications, but that they had been given the vaccine without being adequately warned of its possible adverse effects and had suffered injury. This threat stalled the program until August when Congress passed special legislation that, in substance, made the United States the sole party defendant in all suits based upon the failure to give adequate warnings. In December 1976 the program was temporarily halted when a statistically high incidence of a paralysis known as Guillain-Barré syndrome was detected in persons who had received the vaccine. The original consent forms prepared by HEW did not mention the Guillain-Barré syndrome, and it is likely they were deficient under current legal standards in several other material respects as well. The swine flu program never did revive.

As of March 31, 1977, over $300 million in claims had been filed against the United States for such diverse losses as common colds, sterility and, of course, paralysis. Responsible estimates suggest that another 1 billion dollars in claims remain to be filed. The total of damage pay-outs and legal fees could well exceed the combined costs of all other phases of the program. The age of products liability is upon us.

The swine flu cases represent the most obvious injection into the public consciousness, to date, of that branch of tort law known as products liability. Tort is generally concerned with setting out the conditions under which one person is entitled to recover damages for harm to his person or property inflicted by another. So defined, tort law reaches out to embrace everyday nuisances, auto accidents, medical malpractice cases, and, of course, products liability suits—the subject of this essay.

Concerned generally with the tortious liability of manufacturers and retailers, whether of candy bars or industrial machinery, the law of products liability has undergone numerous changes—some major, some minor—that have, taken together, profoundly increased the probability that a successful suit for damages will be brought against the maker or seller of a product. The present concern with products liability does not arise so much from the changes in the law as from the news, sometimes exaggerated, of insurance rate increases and business failures stemming from these changes. We have by no means reached a crisis in the law of products liability, but we have been experiencing mounting dissatisfaction. Some common product lines—ladders and machine tools to name but two—have been severely affected, and there is a real possibility that major dislocations could occur. It is worth noting that the greatest concern is heard in states like

Richard A. Epstein is professor of law at the University of Chicago and for the past year has served as a special consultant on products liability for the American Insurance Association.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

California where the changes in the law have been most dramatic.

We could, of course, concern ourselves with symptoms, but we would be better advised to deal with causes. The underlying questions are, what are the appropriate liability rules in products liability cases? And how, if at all, have the courts departed from them?

Tort or Compensation?

Much of the present confusion in and about tort law can be traced to the failure to identify that law's central purpose. It is commonly said that the purpose is to provide compensation that will make injured persons whole—to the extent that money can. Whatever the intuitive appeal of this proposition, we can see on close examination that it provides an incorrect framework for evaluating particular rules of tort law. The clue to the error lies in the original meaning of the word "tort." Derived from the Norman French, the word means *wrong*. It is one person's wrongful conduct that results in harm to the person or property of another that lies at the foundation of tortious liability.

Compensation may well be needed for self-inflicted harm, or for harm caused by earthquakes or floods, but such things are not within the province of the tort law no matter how grievous the injuries suffered. A need for compensation is relevant only if the plaintiff's cause of action—his claim for relief—is first established as a matter of legal principle. The fact of harm itself should carry no weight in determining whether a tort has been committed. There is no presumptive injustice in the tort law solely because a plaintiff was denied compensation, just as there is no presumptive injustice because compensation is awarded.

But it may be asked, what judicial principles now operate to determine whether compensation is appropriate in any particular case? And where, if at all, has products liability law gone wrong? To answer these two questions, if only in approximate terms, we begin by noting that the responsibility for any particular injury must be attributable to one or more of four types of causes:

(1) the conduct of the defendant,
(2) the conduct of the plaintiff,
(3) the conduct of any third party, and
(4) some natural force or event, often called an act of God.

In the traditional view of the subject, the defendant in a tort case could not be held liable for acts of God or the conduct of third parties. His answer to a suit claiming damages would not be, "You are not hurt," but instead, "I did not do it." Where, however, the defendant's conduct was causally responsible for the plaintiff's injuries, he could not escape liability merely because some natural event or the conduct of some third party combined with his own conduct to bring about the plaintiff's harm.

The plaintiff's conduct raised special complications. Where it was the sole cause of injury, he had—obviously—no one to blame but himself. Where his own conduct and the defendant's combined to cause his harm, the traditional view denied him recovery except under limited circumstances. Finally, where the plaintiff deliberately encountered a known risk, or even a risk that was "open and obvious" to one in his position, the loss was his alone to bear.

Until recently these basic principles were used with little modification to determine liability in products cases. The defendant could be held responsible for harm caused by the ordinary use of his product where some defect in that product created or brought about the harm. To take a classic example, the plaintiff could recover if a Coke bottle exploded in his hand while being opened. Yet this cause of action would be barred if some third party shook or mishandled the bottle so as to make it dangerous or unsafe, or if the plaintiff himself misused the product. To quote Justice Traynor in his 1944 opinion in *Escola* v. *Coca-Cola:* "The manufacturer's liability should, of course, be defined in terms of the safety of the product in normal and proper use and should not extend to injuries that cannot be traced to the product as it reached the market."

Thus, in determining liability, the standard tort law took fairly into account the contributions of plaintiff, third parties, and acts of God—with the defendant being held liable, roughly speaking, where his own conduct was causally dominant. As it had developed, this law had already abandoned some unrealistic limitations of earlier days, such as the so-called "privity rule," which at one time provided that a user of a product could sue its manufacturer only if he had directly purchased the product from him. It gave not only subsequent purchasers but even innocent bystanders the right to sue manufacturers for the harms caused by

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

dangerous or defective products. Finally, it had accepted a theory of strict liability whereby a manufacturer or seller could be held responsible for the harm caused by his defective product even if he has exercised all possible care in its preparation or sale.

All this is to say that products liability law as fashioned generally through the late 1960s represented a mature and sophisticated set of judgments about appropriate liability rules. If those rules were still operative today, there would be no popular concern, no expert studies, and no cry for legislative reform.

What Has Changed?

There have been several important shifts in the substantive law of products liability. First, dramatic changes have been made in the treatment of a plaintiff's conduct: the "open-and-obvious-risk" defense has given way to a rule that permits the recovery of damages to be barred only by the plaintiff's "voluntarily and unreasonably proceeding to encounter a known danger," narrowly construed.

One recent California case illustrates the extreme to which it is possible to go. In *Buccery* v. *General Motors Corp.*, the plaintiff, Buccery, while driving a van manufactured by General Motors, was struck in the rear by another automobile. Upon impact, Buccery's head was thrown back against the rear window of the cab and he was injured. The van was not equipped with a headrest, and none was required by statute at the time. The trial judge directed the jury to enter a verdict in favor of General Motors, saying in effect that its case was too strong for argument. The appellate court reversed that decision and instructed the trial judge to allow the jury to decide whether the van was dangerously defective and, if so, whether Buccery had assumed the risk of injury associated with that defect. The court also held that this assumption-of-risk defense was not established by the open and obvious condition of the van, inasmuch as Buccery did not perceive the "magnitude" of the risk in being hit by a car going five miles faster than his was. A routine rear-end case has been transformed into a major products liability action.

The story has repeated itself in other areas of the law. Whereas once it was impossible for a worker to recover from the manufacturer of a machine tool when he was injured because he deliberately put his hand near a moving part, in many jurisdictions today the jury may consider the reasonableness of that conduct, and the employee is allowed to invoke the demands imposed on him by his employer to show that his conduct vis-à-vis the manufacturer was reasonable. Likewise, the requirement that the product be used in its normal and proper way has yielded to an alternative rule that places upon manufacturers the burden of protecting the users of their products against the "foreseeable misuse" of those products. The plaintiff who neglects a warning or disregards a safety precaution may still be able to recover full tort damages. The passenger who neglects to buckle up may recover from a manufacturer for the very harm his seatbelt could have prevented. In most jurisdictions the plaintiff's own negligence is not a defense in a products liability action, even though in other contexts that negligence might serve to reduce—if not eliminate—recovery. A speeding motorist may recover full damages from an automobile manufacturer for injuries that he himself could have avoided by reasonable care. A plaintiff who is burned by throwing perfume upon a lighted candle can recover from the manufacturer or retailer of the perfume because they did not warn that perfume was flammable.

A dual standard of responsibility has crept into the law. Conduct that would be sufficient to hold a person responsible for injuries inflicted upon another is ignored or overlooked when that person instead injures himself and then seeks compensation from the manufacturer. Defenses based upon the wrongful conduct of the plaintiff are by degrees being eliminated from the law.

Hand in hand with the contraction of available defenses has gone an expansion in the types of causes of action open to the plaintiff. The concept of defect, never well explained in products liability cases, has now been so interpreted that it is possible to argue that any product which can be made safer, regardless of cost, is a product which the jury can find unsafe. In this connection, two types of cases are of special importance, "design defect" and "duty to warn" cases.

Design defect cases should be placed in sharp opposition to construction defect cases. The latter involve such products as the Coke bottle made with weak glass or sealed under

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

excessive pressure. Design defects, on the other hand, involve such products as the machine tool that is dangerous because an additional guard or safety device could have been installed to protect the worker who ignores the safety devices already in place; or the car whose gas tank arguably could have been repositioned to resist the explosion that occurs when that car is struck by another moving at speeds between 65 and 85 miles per hour.

Perhaps the most graphic illustration of a design defect is a case from the state of Washington, *Doyle* v. *Reid-Strutt Inc.,* where the plaintiff, Doyle, recovered $750,000 for the loss of one leg below the hip. The leg was lost when caught in the gears of a screw auger machine sold and installed by the Reid-Strutt Company. Shortly before the accident, Doyle's fellow employees had removed a panel with sledge hammers and crow bars in order to do repair work on the machine. When finished, they replaced the panel with a single piece of cardboard instead of restoring the equipment to its original condition. Doyle stepped on the cardboard in the course of his work and fell, catching his leg in the moving parts below. The case was sent to the jury to decide whether the injury was caused by defective design, and a verdict was entered for Doyle. The defects in design on which he relied were that the machine was so solidly built that it was difficult to assemble and disassemble, and that it was not equipped with an automatic interlock device that would have prevented it from operation when its panels were not securely in place. By use of such design theories, Doyle was thus able to impose design obligations upon the company to overcome the gross abuse of his fellow workers and his own possible neglect.

The recent expansion of liability in design defect cases marks one of the major transformations of the law. In making a defense in these cases, the manufacturer may be able to persuade the jury of all the delicate tradeoffs that were made in designing a "safe" product (though the question of "how safe is safe enough" is never answered by the courts). But the problems involved in doing so are severe. To collect, the plaintiff need only "redesign" the product after the fact so that the injury he indeed suffered would have been prevented —even though the defendant originally had to design the product to deal with many possible types of accidents, not just the one that in fact occurred. Within this framework it seems only fair that the plaintiff should bear a heavy burden before he can take a case of unsafe design to the jury. Yet today it appears in some jurisdictions to take little more than the unelaborated suggestion of an alternative design from the plaintiff's expert witness for a jury issue to arise. Even where the defense is successful, the costs of major litigation and damage to reputation are left uncompensated.

Sharp limitations on liability are needed in design defect cases. Where the legislature is persuaded after comprehensive study that certain design standards are appropriate, it can pass laws to make them mandatory, and these laws could well permit private causes of action to injured parties. But without legislative action of this sort, a defendant should at least be protected if he has adopted a design in substantial use in his or in a related trade or business.

The fashionable rule today measures the defendant's design choices against a "state of the art" standard determined not by these prevailing practices, but by technological and market *capabilities*. This rule is said to be essential in situations where an entire industry may have "unduly lagged" in adopting appropriate safety standards. The rule has intuitive appeal, although there are to my knowledge few, if any, instances in which backward industries have been adequately identified. But even assuming they exist, the emphasis upon capabilities is beset with major difficulty.

It is much harder to litigate the question of capabilities than the question of current practices. The former has thrust complicated questions of cost into the foreground of litigation. Yet it is difficult to identify which costs are relevant and to measure those that are. The effects of any error in measurement, moreover, are apt to be very severe, because even slight variations in cost estimates may lead to very different conclusions about the need for certain safety precautions. All of these calculations must be made, not as of the date of injury, but as of the time when the product was first placed into the stream of commerce, which could be years before. The best and most progressive firm in any industry is exposed to the dangers of hindsight in determining what was or was not feasible—dangers akin in application and effect to those of retroactive legislation.

Finally, the capabilities standard may in fact reduce personal safety and increase acci-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

dents. The firm that makes its product safe enough to withstand all manner of abuses may make it so expensive to acquire and so difficult to use that consumers will shift to more dangerous products which promise greater convenience. A safe ladder is of little use if left unpurchased in a store or unused in a closet while a homeowner is injured climbing on a table—a point universally neglected in design cases.

Similar caution and restraint are needed in duty-to-warn cases. Here too there is a danger that juries will find any warning "inadequate"—either because it says too little or because it says too much—and will hold defendants responsible for injuries caused in large measure by the conduct of the plaintiff or a third party. Should a manufacturer be held responsible because he has not issued a general warning that moving blades on farm equipment could become sharper with use? Or that steaming hot water inside a vaporizer could scald a small child? And do not the swine flu cases illustrate the potential power of the new duty-to-warn cause of action?

Duty-to-warn cases raise in a somewhat different context the problems that plague the design defect area: expensive litigation, retroactive standards, and the recurrent danger of reducing personal safety while insulating firms from liability. A person bombarded with warnings about the trivial and obvious may ignore the few important warnings that come along.

The continued expansion of design defect and duty-to-warn cases could, in the end, eliminate the tort from tort law. If defendants are required to warn against—and guard against—any and all hazards, the result will be that all accidents will in the eyes of the court have but one possible cause, the defendant's conduct.

Why Is It All Done?

Cost Internalization. First, as argued by Justice Traynor in the famous case of *Greenman* v. *Yuba Power Company,* it is often said that "the purpose of such [strict] liability is to insure that the cost of injuries resulting from defective products are borne by the manufacturers that put such products on the market rather than by injured persons who are powerless to protect themselves." The point is quite sensible when applied to construction defects: it works well with Coke bottles having cracked sides. But the argument contains its own limitations. An auto passenger is not powerless to fasten his seatbelt; a teenage girl is not powerless to abstain from throwing perfume on lighted candles. And all cases of product misuse and modification involve harm that a manufacturer may well be "powerless to protect against," whereas users and others in the distribution chain can protect against it with but little difficulty.

Incentives. A closely related argument is that the expansion of products liability was necessary to give producers the proper incentives for developing safe products. Yet this argument too contains its own implicit limitations. In many situations, incentives belong elsewhere in the chain of distribution. A manufacturer of machine tools cannot compel purchasers to keep them in proper maintenance and repair; he cannot prevent the removal of safety guards and warnings; and he cannot compel individual workers to observe all the required safety precautions. Yet manufacturers, as we have noted, have been held fully liable for damages in precisely these situations. Employers are often in a better position than the original manufacturer to prevent work-site accidents by controlling the work environment or by giving individual employees warnings and instructions about a product's hazards and proper use. General Motors may have billions in assets, but it cannot prevent drunks from speeding or incompetents from rebuilding its car engines. Consideration of incentive effects does not irresistibly lead to a liability rule that ignores the contributions of plaintiffs and third parties. Even if we believed that individuals (as plaintiffs) and firms (as third parties) did not respond to legal incentives, we should not be overhasty to endorse any elimination or contraction of the available products defenses. The destruction of these important defenses, at the very least, may impose perverse incentives upon the defendant whose conduct the law does not seek to regulate. Moreover, it creates the possibility that the good and sensible firm will be dealt with as harshly as the backward and incompetent one, when the very purpose of the law should be to distinguish between them.

Spreading the Loss. Last, it is argued that the expansion of products liability will spread throughout society the cost of compensating individual accident victims. As an initial point,

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

the spreading argument is so powerful that it can eliminate not only the need to show negligence, not only defenses based upon the plaintiff's conduct, but the entire tort law. If the welfare of the injured party becomes the paramount goal, there is no reason why the law should retain the requirements of causation and of product defect.

There are other difficulties as well. Indeed, the full implications of the loss-spreading arguments are rarely confronted. One question is why there is any need at all for a tort system of third party liability, with its cumbrous and expensive machinery of private litigation. A comprehensive system of first party insurance that compensates each person in accordance with the severity of injury seems clearly preferable if "needs" alone are to be taken into account. Under such a scheme, compensation should not be limited to those who are "lucky" enough to be injured by some chance contact with a defective product: the victims of crime, illness, earthquakes and, indeed, self-inflicted harms should be entitled to precisely the same level of protection because they have precisely the same needs.

A second question concerns the level of benefits that should be paid under the scheme. Here the courts have implicitly assumed that each individual claimant should receive generous damages of the kind awarded under the tort system. Yet other systems that have individual compensation as their primary objective have moved sharply away from these high benefit levels. There are, for example, substantial limits upon recovery for pain and suffering and economic loss in no-fault automobile insurance and in most workmen's compensation plans. Likewise, various medical and disability programs provide much more restricted forms of coverage. Why are such limitations inappropriate under a system in which need is the major source of social entitlement?

A third question concerns the source of the contributions to the general compensation scheme. If the purpose of the legal system is to give the citizen a sufficient cushion against major disaster, we are faced not with questions of corrective justice in the individual case, but of basic taxing policy, as in the case of social security. These questions, like other taxing questions, should be addressed by the legislature, where the interdependence and coordination of the many distinct benefit programs can receive comprehensive scrutiny. Only in a collective setting can we make a prudent weighing of the overall costs and benefits of any particular compensation scheme.

Conclusions

The transformation of the tort law in products liability cases has been great indeed, and in my view it represents a clear instance of a misguided judicial approach to public policy questions. Torts has always been divided into two general parts. The first is a pure form of public regulation, designed to protect individuals from the aggressions of strangers. The second is an extended form of private agreements, designed to allocate the loss between persons bound by a web of social understandings. In fleshing out the unstated obligations of these relationships, judges at one time were anxious to make their rules conform, insofar as possible, to the implicit shared expectations of all the parties. Today, by a conscious adoption of judicial regulation, most courts seem less interested in mirroring shared expectations and more intent upon revolutionizing them.

I do not wish to argue that all such judicial regulation is unwise in products liability actions, as it is clear to me that private contracts between manufacturers and users are of limited utility in these situations, given the number of times a product may change hands once it is beyond the manufacturer's control. Yet before we make the obligations of manufacturers too onerous, we should bear in mind the perils of such expansion. There is the risk of standardless litigation. There is the risk of making manufacturers and sellers bear the risk of loss when others in the chain of distribution, including the injured party, are better able to prevent the harm in question. There is the risk of high administrative costs. There is, finally, the risk of ignoring first-party mechanisms for insurance that may better provide minimum protection for injured parties.

There is, in short, the great danger that, as a society, we will ask too much from the manufacturers and suppliers of goods, and too much from an expanded tort system itself. Should that day come—and it may—then what today is a troublesome problem for certain firms and certain industries could well become a major social crisis. ■

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

An Ambiguous Beginning

Will Carter Put Out the Fire?

David R. Gergen

AT A SEMINAR in Washington this summer, a young lady arose to challenge the attorney general of the United States. "If you believe in free markets, as you say, Mr. Attorney General, how can you justify the fact that the government now regulates so much of our society and intervenes so heavily in our personal lives?"

"Well," replied Griffin Bell, "the President and I both like to answer that by recalling what a man said after he had been charged with public drunkenness and setting his bed on fire. 'Your honor,' he said, 'I plead guilty to being drunk the other night, but the bed was on fire when I got into it.' "[1]

Bell had a telling point. For those who believe that the government excessively interferes in private decision-making, the problem flared up long before the Carter team came to Washington, and no one in the new crowd can reasonably be expected to bear the blame.

Yet, six months after its arrival, there is mounting evidence that the Carter administration is having considerable difficulty of its own in damping the fires of governmental regulation. It has hauled out all the engine companies with a great clanging of bells, and in some areas it has indeed made progress. But in others it only seems to be fanning the flames.

Just as the Ford administration learned to its chagrin, the Carter administration is also coming hard up against the fact that regulatory growth has achieved a momentum of its own that even the most ardent anti-regulators have trouble in stemming. Because of statutes already on the books and the mentality that seizes federal agencies, government regulations have become like government expenditures: many of them are now "uncontrollable." As one of the leaders in regulatory reform under the Ford administration puts it: "We've reached the point where it is unrealistic to think that a President can simply roll back the tide of regulations that has swept over us. The most we can hope for now is to prevent a surge of new ones, and even that is going to take extremely dedicated, persistent leadership from the White House."[2]

Jimmy Carter never tried to convert regulatory reform into a major campaign issue in the same way as Gerald Ford, but since coming into office, he has often spoken of his commitment to reducing regulations. In a message to Congress on March 4, for instance, Carter said: "One of my Administration's major goals is to free the American people from the burden of overregulation. We must look, industry by industry, at what effect regulation has —whether it protects the public interest or whether it simply blunts the healthy forces of competition, inflates prices and discourages business innovation. Whenever it seems likely that the free market would better serve the public, we will eliminate government regulation."

David Gergen is a free-lance writer and consultant in Washington, D.C. He previously served as special counsel to the President and director of communications under President Ford and as chief of the writing and research department under President Nixon.

[1]Statement made at a private seminar in Washington, D.C., this summer.

[2]This quotation and others where the speaker is not identified come from officials who wished to remain anonymous.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Matching Rhetoric and Reality

The President's difficulties in squaring rhetoric with the reality are illustrated by the pledges he made in his first fireside chat to the nation less than two weeks after taking office. To lessen the burden of governmental regulations, Carter promised that (1) every new regulation would be read by a Cabinet officer before it was issued, (2) the number and length of regulations would be cut, (3) regulations would be written "in plain English for a change," and (4) every new regulation would be signed by its author.

Promise number one sent snickers through the bureaucracy. As one reporter said in the *Washington Post,* keeping that promise would mean that Joseph Califano, secretary of the Department of Health, Education, and Welfare, would have to read the equivalent of *War and Peace* once or twice a week. Or Secretary Brock Adams at Transportation would have to stack his bedside reading table with 680 single-spaced pages of the latest missive on airline safety. Within a few weeks, the White House realized that the rule was being honored mostly in the breach and it quietly rescinded the order.

Promise number two seems to be suffering the same fate. During the first six months of calender year 1977, some 33,704 pages of newly proposed rules and regulations were printed in the *Federal Register,* setting a new record and exceeding the previous year by a full 25 percent.

Carter's third promise—to render new regulations in plainer English—has met with more success. Before the President's fireside speech, the director of the *Federal Register,* Fred J. Emery, had started a monthly four-day seminar in regulation writing and had decreed that all new regulations contain a simplified preamble explaining the purpose of the regulation, but neither move had captured great attention. Since the President's speech, however, enrollment at Emery's classes has more than doubled and waiting lines have developed through November.

As for the promise to have the author of the regulation publicly attach his name to the document, it was quickly recognized that new regulations are frequently the product of many hands. Instead of arbitrarily assigning responsibility, the *Register* has begun to include in each new regulation the name and address of a single individual in an agency who can be contacted for further information. In some cases, agencies also voluntarily add the name of the drafter.

Thus, of the four changes that the President tried to make in January, one is being faithfully pursued, one has been watered down, and two have been frustrated. Is that success or failure? Much probably lies in the eyes of the beholder.

. . . looking at the entire record of the Carter administration during its first six months, it is possible to read two widely differing interpretations into its commitment and progress on regulatory reform. Those who choose to do so can conclude from his rhetoric and actions that the President is a determined, dedicated reformer. But others can just as easily reach the opposite conclusion.

Indeed, looking at the entire record of the Carter administration during its first six months, it is possible to read two widely differing interpretations into its commitment and progress on regulatory reform. Those who choose to do so can conclude from his rhetoric and actions that the President is a determined, dedicated reformer. But others can just as easily reach the opposite conclusion.

The truth seems to be that the President is personally committed to regulatory reform and to free markets but is willing to steer a jagged course, making exceptions wherever a reasonable case can be made for greater governmental control. As time passes, the administration also seems to be less and less interested in eliminating regulations per se and more and more concerned with the efficiency, effectiveness, and fairness of the regulatory system.

Carter as Pro-Regulator

For detractors, the most obvious source of dismay is that the Carter administration has put forth proposals in several areas that would require sweeping new federal regulations and

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

controls. In his first six months in office, the President personally proposed or supported the following:

- Massive new controls over the production, pricing, and consumption of energy;
- New controls over hospital costs, with a suggestion by Secretary Califano that controls over physicians' fees may also be in the offing;
- Tougher regulations for toxic chemicals, water quality standards, and occupational health hazards;
- Creation of an agency for consumer protection that would have no rulemaking authority of its own but would assuredly become a potent force for new regulations in other agencies;
- Increasing federal intervention in agricultural markets to ensure higher prices for farmers and stabilize international trade in several key commodities;
- New controls over tankers to reduce the threat of oil spills; and
- Passage of cargo preference legislation that would initially require 4.5 percent of all oil imports to be carried in U.S.-flag tankers, with the percentage rising to 9.5 in five years.

"There are some areas of national life where the public interest is so critical that it overcomes any bias against governmental intervention," explains one administration official. "Energy is a prime example. In the last Administration there was a lot of anti-regulation talk about energy, but in the crunch, Ford signed an energy bill that contained many new controls. Carter has been forced to bite the same bullet, and we're not afraid to admit it."

Beyond the specific legislative changes he has supported, the President has also made several high-level appointments that suggest a tightening of the regulatory apparatus. Michael Pertschuk, the new chairman of the Federal Trade Commission (FTC) was former chief counsel for the Senate Commerce Committee where he helped to father the Consumer Product Safety Commission and laws strengthening federal power over trade. Pertschuk has been publicly quoted as saying that businessmen have "every reason to fear us." The new head of the highway safety program in Washington, Joan Claybrook, used to run Ralph Nader's Congress Watch and was a vocal proponent of auto airbags. The new head of the Occupational Safety and Health Administration (OSHA), Eula Bingham, was recommended to the administration by the AFL-CIO and once chaired the OSHA committee that produced controversial new emission standards for coke ovens. At the Federal Energy Administration, John O'Leary and several of his aides have long been identified with more controls over energy. And at the Transportation Department, Secretary Adams forthrightly opposed deregulation while serving in Congress.

A third factor cited by detractors—and one recognized in some parts of the administration—is the Carterites' continuing inability to follow through on their own best intentions.

In the early days of the administration, a general paper on deregulation was prepared for the President, and it was sent in to him along with a recent *Fortune* article by Paul Weaver suggesting that the time was right for reform in several critical areas. The President sent out a note saying that he would like to have a comprehensive regulatory message prepared for transmission to the Congress. But that has never happened. Instead, the general paper has bounced around from office to office over several months, and policy has continued to be made on an ad hoc basis. In fact, the administration has yet to submit to the Congress a single legislative proposal of its own for substantive overhaul of the regulatory process; all of its pronouncements have been endorsements or general outlines of desired changes.

"There's no question that many people here share a sense of disappointment about our progress during the first six months," says one ranking administration aide. "The President definitely wants to cut back on regulation and harrassment. He wants to promote competition. But our efforts to reach those goals have been hampered by the initial problems of settling in and then by the uncertainty over how the White House and executive office would be reorganized."

Another problem that has slowed the pace of reform efforts, according to some insiders, is that the President has neither a chief of staff nor a high-level coordinator to push for sustained action from within. As a result, reform proposals are often given enthusiastic support by individual members of the administration, but no one has the cachet to guide them through the bureaucracy. In the past administration, Roderick Hills first assumed that role and then, after he was named chairman of the Securities and Exchange Commis-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

sion, Deputy Counsel to the President Edward Schmults became the point man for reform, working closely with one of the President's chief economic advisers, Paul MacAvoy.

Carter as Anti-Regulator

Prospects for reform in the Carter administration seemed to take a definite turn for the better in early August as lingering questions over White House reorganization were resolved and the President's staff could concentrate more fully on substantive issues.

Prospects for reform in the Carter administration seemed to take a definite turn for the better in early August as lingering questions over White House reorganization were resolved and the President's staff could concentrate more fully on substantive issues.

First, President Carter tentatively approved and the Office of Management and Budget (OMB) then sent to agency and department heads a proposed set of guidelines to govern the way that they draft and issue regulations. Underlying the guidelines is the view that regulations are too often written from a narrow agency perspective, failing to take into account broad, general policy needs or their full economic impact. The guidelines suggest that policy oversight and economic analysis ought to be introduced into the process from its inception, not after the regulations are formally proposed. The guidelines also call for "sunset review" of old regulations.[3] Later this fall, after agency comments on the proposed guidelines have been received and studied, the President's advisers hope to reissue final guidelines in the form of an executive order. Second, the OMB began moving in August toward the formation of a new division that would have specific oversight responsibility for the government's regulatory process. Wayne G. Granquist, a political appointee, is to become the OMB associate director for management and regulatory policy, while Stanley E. Morris, a career civil servant and veteran of regulatory reform, is to become deputy associate director of the Regulatory Policy and Reports Management Division.

In the eyes of many Carterites who have been tilling the regulatory vineyards since January, the guidelines and restructuring of OMB are welcome steps forward but instead of representing breakthroughs—as some believe—they are just two more gains along a steady continuum. In their view, the administration had already built a solid record of achievement long before August. Among the reforms they cite:

- In May, the President urged passage of "ethics in government" legislation that would strengthen the requirements for financial disclosure by officials of the executive branch and would broaden the ban against contacts with a government agency or department that an official has just left.
- This summer, the administration endorsed S. 600, a regulatory reform bill sponsored by Senators Robert Byrd, Charles Percy and Abraham Ribicoff that would require both the executive and legislative branches to conduct a systematic examination of all regulatory activities over the next eight years.
- The administration is also supporting sunset legislation that would require most federal programs to undergo periodic review, a measure thought to complement Carter's zero-based budgetry.
- In a series of meetings early in his administration, Carter asked university presidents, state school superintendents, manufacturers, and others to keep him posted on federal paperwork and regulatory requirements they found to be unnecessary and obnoxious.
- The administration has also been working to eliminate overlapping, contradictory edicts from Washington. In May, for instance, three different agencies—the Food and Drug Administration (FDA), the Consumer Products Safety Commission, and the Environmental Protection Agency (EPA)—joined to impose a ban on fluorocarbons with a single timetable. Douglas M. Costle, EPA head, and Eula Bingham of OSHA have both promised they will synchronize their efforts on other projects in the future, such as a study of benzene.

[3]Sunset review is a relatively new concept in government. As used here, it means essentially that an agency would be required to review its regulations periodically. The "sun would set" on any regulation that the agency did not reauthorize by a preestablished time.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

• Under the leadership of Charles Schultze, the administration is trying to continue the efforts of the Ford White House to force agencies into evaluating economic costs before issuing a new regulation (see article by James C. Miller in the July/August issue of *Regulation*). Carter has endorsed the project, but as of early August, it was still in the idea stage.

• Finally, the administration is studying the idea, articulated by Schultze in his Godkin Lectures (see page 10, this issue), of substituting economic incentives and disincentives for prescriptive rulemaking as a better way to reach regulatory objectives. In May, Schultze, Bert Lance of OMB, and Stuart Eizenstat sent a memorandum to the President suggesting that expanded workers' compensation—or an "injury rate tax"—might be a better way to reduce industrial accidents than comprehensive federal standards. More recently, Lance and Labor Secretary Ray Marshall have set up a high-level task force to review the entire area of industrial health and safety. The idea could possibly be derailed before it is effectively launched: shortly after word of the task force reached the press, organized labor and at least one powerful senator sent blistering objections to the White House, warning that the contemplated charges could dilute the power of OSHA.

Overview of Other Actions

In addition to the initiatives noted above, the first six months of the Carter presidency have also brought many developments—some favoring less, others favoring more regulation—within several major policy areas. Here is a brief summary of highlights:

Transportation. Carter took office at a propitious moment for reform of airline regulations. Senators Edward Kennedy and Howard W. Cannon had already held extensive hearings on the issue and had developed their own legislation; President Ford had also submitted reform legislation; and the press had begun to give the matter favorable attention. Carter chose to move swiftly, and on March 4 he sent a message to Congress endorsing the Kennedy-Cannon effort to relax the CAB's authority over routes and fares for interstate domestic airlines. Transportation Secretary Brock Adams, long a proponent of stiff regulation, testified only half-heartedly in favor of the President's position, but in recent weeks has swung behind it. Although industry and labor opposition continues to be intense, and the bill has been slowed in Congress, the administration is still optimistic about Senate passage this fall and House action in 1977.

In the meantime, there are growing doubts about the administration's plans on trucking deregulation. In his town meeting in Clinton, Massachusetts, in February, Carter promised that a staff review of trucking would be completed within a few weeks, and expectations grew that the administration would submit legislation in the spring. When a bill failed to materialize, the official explanation was that the administration wanted to await completion of congressional action on airline deregulation; one unofficial explanation was that the trucking industry began applying heavy pressure against reforms even before Air Force One returned from Clinton. Now, the latest word is that Secretary Adams has been so impressed with the commitment to trucking reforms of A. Daniel O'Neal, the new chairman of the Interstate Commerce Commission, that he wants to leave the reform effort in the hands of the ICC (see "ICC Staff Task Force Report," page 41, of this issue).

Occupational safety and health. OSHA won widespread public support this spring when it announced that henceforth it would concentrate only on major, serious health hazards, leaving aside the minor investigations that have irritated people as divergent as Billy Carter and the groundskeepers of the U.S. Capitol. The end has come to "Mickey Mouse" regulations, announced Secretary Marshall; whether he holds to that pledge remains to be seen.

Environmental protection. A new surge of environmental restrictions seems inevitable during the Carter years. His own environmental message to the Congress, supporting tougher standards for industrial discharges of toxic chemicals, water quality, and occupational hazards, points conclusively in that direction. The President also signed a strip-mining bill that Ford twice vetoed, and he permitted the auto industry only a one-year delay on tougher air standards (they had wanted three years). In addition, the Carter administration will be responsible for implementing the Toxic Substances Control Act of 1976, which

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

requires the government to regulate more than 30,000 chemicals. It is estimated that more than 7,000 civil servants may be needed to enforce the law. Early skirmishes have already suggested to private companies that the administration plans to be tough in its new regulations.

Consumer protection. Early signs indicate that the Carter administration may also create stiffer rules and regulations in the consumer field. In addition to his support for the consumer protection agency, the President has named two "activists" to head up the FTC and the FDA.

At the FTC, Michael Pertschuk sent ripples through the advertising world early this summer with reports that he might seek to regulate advertising that the government considers "unfair," as opposed to past government bans against advertising that is "untrue." His theory apparently is that some advertising promotes habits that contravene the national interest—for example, car ads that encourage more driving or children's ads that whet materialistic instincts—and the government ought to put an end to it. The FTC has another struggle on its hands with the tobacco industry over cigarette advertising; that fight extends back into earlier years but it heated up this spring. Not unmindful of critics that its recent activism has created a spate of new problems in the private sector, the FTC is also engaged in an internal effort to evaluate its own consumer rules to determine whether they are working as intended, and agency officials have indicated that these "impact evaluations" may well lead to internal reforms.

In his first few months in office, the new commissioner of the Food and Drug Administration, Dr. Donald Kennedy, has lived up to his reputation as a "tough cop," clashing more than once with industry over issues such as the saccharin ban and the amount of data that private drug companies must provide to the government. At the same time, however, Kennedy has been seeking ways to reduce the long delays before new drugs can reach commercial markets. The FDA's cumbersome procedures have been roundly attacked in the past, and among its more recent critics is its new departmental boss, Joe Califano.

Banking. Regulation of the banking industry has been a controversial issue in Congress for more than a year, and the Carter administration at first seemed unable to make up its mind on what it wanted. Then in late June, it threw its support behind a bill that would allow banks and thrift institutions to pay interest on demand deposits, or NOW accounts. Coupled to that legislation is authority for the Federal Reserve System to pay interest on reserves that it requires from member banks. The measure, opposed by small banks which fear that NOW accounts could force them out of business, ran into trouble in the Senate in July, and both the administration and Federal Reserve Board Chairman Arthur Burns began looking for an acceptable compromise.

Actions at the Justice Department. Attorney General Bell and the young head of the Antitrust Division, John Shenefield, along with Pertschuk at the FTC, have been sending out a steady stream of signals that the government should take a much more aggressive approach to industrial concentration. Companies that dominate their fields through their own marketing and economic efficiency may no longer be immune from attack, and bigness per se—as opposed to anticompetitive behavior—may become a foundation for government antitrust suits.

The Justice Department is also circulating a memorandum suggesting that private class action suits might be a useful new weapon for enforcing the decrees of regulatory agencies. Legislation permitting such suits would bring howls of protest from the business community (*Barron's* recently called them "legal lynch mobs"), but a bill allowing their use to enforce the rules and regulations of the Federal Trade Commission is now wending its way through both houses of Congress.

IN SUMMARY, during its first six months in office the Carter administration has constructed a record of almost studied ambiguity on regulatory reform. The President's rhetoric on this subject has always been tinged with a missionary zeal, and many of his actions have pointed toward a substantial reduction in the regulatory burden. Yet, many other actions and proposals indicate that his commitment is not uniformly shared among his appointees and that Carter himself, when faced with contravening political or economic pressures, is quite willing to bend in the other direction. Unless there is a sharp change in strategy, the "fire in Washington" promises to burn on for some time to come. ■

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Valuable Operating Rights in a "Competitive" Industry

A Paradox of Regulated Trucking

Milton Kafoglis

ADAM SMITH wrote in *The Wealth of Nations* that "every individual necessarily labours to render the annual revenue of the society as great as he can . . . and he is in this, as in many cases, led by an invisible hand to promote an end which was no part of his intention." In other words, the public interest is best served through the pursuit of private interest. This apparent paradox is quickly resolved when we identify the "invisible hand" as the competitive market—an arrangement that permits the individual to pursue his own self-interest without penalizing other members of society. Indeed, many economists have devoted their lives to examining the intricacies of "Smith's paradox" in complex situations.

When a benign government seeks to serve the public interest by substituting its visible, frequently coercive, and often selective hand for Smith's invisible, volitional, and impersonal hand, new paradoxes appear. Unlike Smith's, some of these cannot be rationally resolved and are, therefore, absurdities. Our subject is one of these.

Consider the following. The trucking industry is said to be earning no more than a "competitive" return on its assets, but entrepreneurs are paying large sums for the right to operate as truckers in this "competitive" market. That is, they spend millions of dollars each year to purchase existing operating rights from other truckers and millions more to obtain new operating rights from the Interstate Commerce Commission (ICC). If returns to the transportation-related assets were in fact competitive, truckers would not pay such sums for operating rights, because this would force their rate of return below the competitive level—below what these assets could earn elsewhere.

Since the ICC controls the supply of operating rights (also called "operating authorities" or "operating certificates"), the question that arises is whether the commission creates an artificial scarcity of supply or in some other way permits the industry to earn excessive returns. If it does, we no longer have a paradox—just poor or unnecessary regulation.

The commission argues that because truckers are not permitted to include the value of their operating rights in the assets on which they are entitled to a return, the existence of these rights does not lead to higher truck rates. The commission also argues that it does not significantly limit the supply of operating rights, since it approves over 80 percent of the applications it receives. If rights are easy to acquire and if truck rates are set so that the industry earns a "competitive" return on its transportation-related assets, the paradox reappears, and one is left wondering about the business sense of those who pay huge sums for these rights.

Background

At this point we should note the historical origins of the apparent contradiction we have identified. The basic structure of trucking regulation was established by the Motor Carrier

Milton Z. Kafoglis, professor of economics at the University of Florida (on leave), is staff economist at the Council on Wage and Price Stability. *He wishes to express his thanks to James C. Miller III who suggested and encouraged this research effort.*

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Act of 1935. At that time the economy was in the throes of the Great Depression, and there grew a demand that industry be protected from the evils of "destructive competition." Conditions seemed particularly bad in the trucking industry. The business was an easy one for enterprising individuals to enter and provided an alternative to industrial unemployment. With considerable new entry occurring, truck rates declined as hard-pressed truck operators struggled to compete for customers.

The gains to consumers from lower trucking rates did not persuade the policy-makers of that time. Instead, they accepted the argument that equipment was being inadequately maintained, that driving times had lengthened, and that "unethical" operators were creating unsafe conditions. The railroads and large trucking firms, whose established markets were being threatened, were joined by large shippers and the ICC, which was concerned about the viability of "common carriage," in demanding an extension of regulation to the trucking industry. The principal purposes of regulating the truckers were to "protect" the common-carrier system from competition by treating motor carriers like railroads and to stabilize prices and capacity in trucking.

The essential techniques of railroad regulation—a system designed to control monopoly—were applied to the diverse and atomistic trucking industry in an environment characterized not by monopoly but by intense rivalry. First, with some exceptions, the ICC was granted power to approve and suspend rates charged by for-hire motor carriers. In determining just and reasonable rates the commission did not, as is usually the case in public utility regulation, directly establish a fair rate of return on investment. It considered a number of factors, but relied most heavily on the operating ratio (the ratio of operating costs to revenues) as a criterion for evaluating rate increases. This type of regulation, along with the antitrust immunity subsequently granted to motor-carrier rate bureaus (organizations used by truckers to establish rates through joint "agreement"), has led to inflexible prices and the virtual elimination of price competition among truckers.

Second, the ICC was granted control over entry into the industry. Common carriers (those which provide services to the general public) must obtain from the ICC "certificates of public convenience and necessity" to transport particular classes of goods over particular routes.[1] The "need" for a new certificate is easily contested by carriers already operating in the particular transportation market. These certificates—or rights—contain various restrictions, including specification of routes, gateway restrictions (that is, restrictions on the routes a carrier can use when passing from the territory of one ratemaking bureau to that of another), limitations that increase empty backhauls, and restrictions on particular commodities hauled. As a result, route structures are often circuitous, and route and service offerings quite inflexible to changes in the demand for service. Some of these inefficiencies have been relieved by ICC action and by the carriers themselves as larger firms have bought certificates from smaller firms in order to make their routes more efficient. But the problem is far from resolved.

What Are Operating Rights Worth?

According to a 1974 report of the American Trucking Associations (ATA), "Recent acquisitions in the motor carrier industry indicate that amounts paid for operating authorities are approximately 15% to 20% of the annual revenue produced by those authorities." Indeed, the report describes operating rights as the industry's "most important asset."

Operating rights are issued only if the proposed service "is or will be required by the present or future public convenience and necessity" (49 U.S. Code, section 307). The commission seldom grants an application that threatens the financial health of existing carriers. Regulatory policy thus supports the survival of existing firms and significantly reduces entrepreneurial risk. The ICC thinks this is desirable because it leads to "stability" and lower borrowing rates for truckers. Bankers tend to view operating rights as assets that can be sold in the event of bankruptcy, as protection from harsh competition, and as representing a preferential claim on new business.

The commission grants over 4,000 operating rights a year, denying only a small portion

[1]Most of the operating rights in existence today arose under the so-called grandfather clause of the Motor Carrier Act. Congress made special provision to protect the interests of motor carriers in bona fide operations prior to the passage of the act by not requiring these carriers to prove public need in order to continue in operation.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

of those that are requested. In view of this, why are existing operating rights purchased for huge sums? Why do not truckers simply apply directly to the commission and receive their rights for no more than the expense of hiring an attorney? The answer is that if they really intend to compete with existing firms, they will necessarily "injure" those firms. Doubtless, many truckers who want rights are advised by their attorneys not to apply because they cannot meet the "no injury" standard.[2] Beyond these basic regulatory obstacles, the application procedure is lengthy and costly, involving legal and other costs far in excess of those available to most would-be entrepreneurs.

The fact that the commission acts favorably on most applications does not mean that entry is easy. The new operating rights that are granted are generally specific and narrow with respect to the origins and destinations of traffic and the commodities to be carried. They are granted, for example, when a new plant opens (and may limit the carrier to serving just that plant) or when they are simple extensions of existing rights not contested by other truckers. Entry that creates direct, new competition is rare, notwithstanding the leniency claimed by the ICC. Thus entrepreneurs wishing to set up trucking businesses of any size or to extend their operations substantially usually must purchase expensive operating rights. (These purchases must be approved by the ICC, but this is a routine procedure and imposes no impediment to such transactions.)

Over the ten-year period, 1963 through 1972, total investment in operating rights shown on the balance sheets of Class I common carriers of general freight grew from about $65 million to about $300 million according to the ATA—or at an annual compounded rate of approximately 16 percent. The balance sheet increase resulted primarily from the sale of these rights at prices above book value, meaning that the truckers who bought the rights carry them on their books at higher values than the truckers who sold them. Since book values increase only when rights are sold, existing rights not recently traded are seriously undervalued on the books. Thus, the figure of about $300 million for year-end 1972 grossly understates their market value. For example, Associated Transport, Inc., carried operating rights on its balance sheet at $976,000 but sold them in 1976 at public auction for $20.6 million. The same year, Eastern Freightway, Inc., sold rights carried on its books at $450,000 for about $3.8 million.

The ICC recently released information on forty-three transactions in operating rights from 1967 through 1971 (see table). These transactions involved no assets beyond the operating right. The forty-three rights were purchased originally for a total of $776,800 and were later sold for a total of $3,844,100. The average length of time they were held is 10.1 years, so that their aggregate value increased at a compounded annual rate of 17 percent. Adjusting the sales figure to constant (1972) dollars reduces the annual increase to 13 percent. The "average" trucking company (as represented by the forty-three transactions) thus earned a "capital gain" of 13 percent a year on its operating right (in real terms), plus an after-tax return on its investment in other assets of 9 to 17 percent (the 1970-1975 range).[3] The after-tax return on investment of 9 to 17 percent exceeds that earned by public utilities and compares quite favorably with results in unregulated markets. The higher return from the sale of operating rights, of course, raises the truckers' overall return. Given the degree of protection from competition that is inherent in a regulated industry and the low risk of failure, this return—putting it mildly—seems high.

It is interesting to note that the rate of return earned on the operating rights covered in the table (that is, the rate of increase in their value) declined with the length of time the rights were held. One possible reason is that as a route structure grows older it becomes less efficient because—owing to ICC restrictions—it cannot be adjusted to changes in transportation demand. Another is that competition develops along older routes and reduces profits—but, given the problems of entry, this seems unlikely.

[2]Competition typically involves the provision of a better service or lower prices than are provided by the existing firm and will thus lead to a weakening of the existing firm's financial condition. A potential entrant who would make consumers better off thus would have difficulty meeting ICC standards.

[3] After-tax returns on investment of Class I motor carriers ranged from a low of 9.0 percent in 1970 to a high of 17.5 percent in 1972, and averaged 13.27 percent in 1975 (ICC annual reports, 1971-1976). According to *Business Week* (November 15, 1976), the average rate of return on equity for the year ending September 30, 1976, was 13.7 percent for the all-industry composite and 20.9 percent for the truck companies included in the survey.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

RATES OF RETURN EARNED ON 43 TRANSACTIONS IN OPERATING RIGHTS, 1967-1971

Years Rights Held	Purchase Price (000)	Sale Price (000)	Compound Annual Rates of Return: Current dollars	Compound Annual Rates of Return: 1972 dollars
1	3.0	23.0	667%	620%
1	2.5	17.0	580	576
1	15.3	100.0	554	554
1	29.4	151.6	416	390
1	3.0	15.0	400	329
1	17.5	50.0	186	186
1	16.8	22.5	34	27
1	30.0	31.9	6	2
1	10.0	10.0	0	0
2	20.2	50.8	58	51
2	25.6	20.0	−12	−14
3	10.0	40.0	58	51
3	18.0	50.0	40	34
4	10.0	400.0	151	138
5	1.1	40.0	105	98
7	9.8	265.2	60	56
7	8.8	80.0	37	33
7	102.7	349.4	19	16
7	10.8	35.0	18	14
7	26.0	65.0	13	9
7	38.0	38.0	0	0
7	5.0	1.0	−20	−23
9	25.3	50.0	8	4
10	25.8	274.2	27	24
10	13.0	55.0	16	12
11	11.0	350.0	37	33
11	2.3	10.0	14	11
11	10.0	25.0	8	5
12	15.0	15.0	0	1
15	32.8	175.0	12	9
16	2.8	45.0	19	16
16	13.5	85.0	12	10
17	2.5	30.0	16	13
17	105.0	113.5	0	−2
18	5.5	340.0	63	25
18	4.1	23.0	10	7
20	22.0	90.0	7	4
22	2.5	20.0	10	7
22	9.4	59.0	9	6
22	24.6	75.0	5	2
24	16.0	100.0	8	5
28	6.2	50.0	8	4
29	14.0	14.0	0	−4
Average life: 10.1 years				
Totals				
Current dollars:	776.8	3,844.1	17	
Constant (1972) dollars:	1,163.1	4,181.4		13
Mean percent return (unweighted), 1972 dollars:				78
1 year				298
0-5 years*				203
5-10 years				15
10-20 years				11
Over 20 years				3

*Includes one-year rights.
Source: Data provided by Interstate Commerce Commission.

Since the sample of forty-three transactions is small and includes only operating rights that were actually sold, we should not place a great deal of confidence in the precise results. Yet, the results do conform generally to the ATA figures cited earlier and are conservative compared with some recent unpublished estimates made by Thomas G. Moore.[4]

The ICC is aware that operating rights increase in value over time. A February 1972 statement issued to motor carriers by the ICC's Bureau of Accounts states that "in a preponderance of cases where carrier operating rights are acquired through a business combination we are of the opinion that the value of those rights tends to increase rather than diminish. However, we are undecided as to the underlying cause of the increase." This conclusion seems incredible and suggests that the commission has made little effort to evaluate this crucial asset. There must be some reason why the operating rights increase in value over time, and that reason may be related to failures in the regulatory system.

Why Do Operating Rights Increase in Value?

The value of an operating right is the present value of profits in excess of those needed to maintain investment in the industry. In a genuinely competitive industry, the rate of return earned on investment is equal to that required to maintain and attract capital. Economists refer to this rate of return as the "cost of capital." It happens that in the regulated trucking industry a "gap" has been created between the actual return and the cost of capital. Such a "gap" can be created by permitting excessive rates and may be widened if control of entry creates some monopoly power. If this "gap" is expected to persist, the excessive return will become capitalized, giving value to the oper-

[4]When rights are purchased, carriers are required to file a "giving effect" statement with the ICC. This statement includes an estimate of the profit that would have been earned had the rights been owned in the most recent period. Moore examined ten such statements and found that the expected return on the investment in rights was 35 percent. The "giving effect" statement probably gives undue influence to near-term factors so that Moore's figure may be related to the returns on the rights in our sample that have been held a short period of time. (Thomas G. Moore, "Beneficiaries of Trucking Regulation," preliminary discussion paper, June 21, 1976, p. 21.)

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

ating right. A continuous rise in the value of an operating right suggests that the present value of the stream of excess profits becomes successively higher each year *and that this had not been predicted* (that is, not capitalized).

What has caused this constant reevaluation upward in the expected stream of excess profits? There is no obvious answer, but let us suggest two possible explanations: (1) rates of return may *continuously* exceed those required to maintain firms in the industry, and (2) inflexible route structures may become inefficient over time, leading to a market for the trading of operating rights among firms seeking to improve their route structures.

Effects of Excessive Rates of Return. Consider the first possibility. Suppose that an entrepreneur is willing to invest in the trucking business at an after-tax return on total investment of 10 percent, but that the ICC views 12 percent as the appropriate return and regulates the trucker accordingly.

Suppose now that the entrepreneur is granted an operating right, invests $80,000, and reinvests the profits. In the first year, the trucker will earn a profit of $9,600 (12 percent) on the original $80,000 investment, including $1,600 in excess of the 10 percent minimum he or she is willing to accept. This excess return will be capitalized, and the operating right will now be valued at $16,000 ($1,600 divided by .10). If the earnings of $9,600 are reinvested, the trucker will have physical assets of $89,600 and, the next year, will earn $10,752 on this amount, or $1,792 more than could have been earned at a 10 percent rate of return. The value of the operating right thus becomes $17,920 (that is, $1,792 divided by .10). The percentage growth in the value of the operating right is, under our assumptions, precisely equal to the percentage growth in assets invested. Thus, the value of operating authorities grows in direct proportion to the growth of the industry.

This scenario may help to explain the continuous compounded rate of growth in the value of the operating right. As indicated, the original value of the operating right is created by the capitalized value of an expected excess return, and the growth in value is created by the continuous earning of excess returns on new assets and by the inclusion of these excess earnings in the value of the right.[5] A difficulty here is that if it were known that assets would grow, the "excess" associated with new assets would also be capitalized, the compounding process would not occur, and the value of operating rights would stabilize. But of course, though growth can be predicted, it cannot be known with certainty.

The analysis suggests that the return to regulated trucking is excessive, so that we should expect individuals to attempt to enter the industry and "undercut" existing truckers. Since entry is limited, this should lead to illicit operations and imaginative schemes for entering the industry without ICC authority. This, in fact, seems to be the case. For example, agricultural cooperatives are exempt from trucking regulation provided that they haul agricultural products. A major problem for the ICC has been to prevent the creation of "sham" cooperatives that illegally transport commodities at rates lower than those established by regulation. There are numerous examples of such schemes to enter the industry without authority. To me, this means that regulated rates are excessive and fortifies the analysis set forth here.

Effects of Route Inflexibility. As we have noted, truckers must operate within the limits of their operating rights and cannot easily adjust their route structures as the pattern of demand for trucking changes. Over time, these "frozen" structures lose earning capacity. Inefficiencies appear in the form of increased circuitousness, interlining, and underutilization. Rates of return may decline and operating ratios may increase, leading to increases in costs and to justification for rate increases.

The trucker who wishes to expand or rationalize an outmoded route structure may be unable to do so if that would infringe on routes served by others. So, instead, he will purchase a right from another trucker and perhaps sell a

[5] It could be argued that the payment for an operating right is a payment for "goodwill." There may be some truth in this view. To the extent that the concept of goodwill refers to monopoly advantages (location) and the return on a protected investment, it includes some of the elements noted above. But as an explanation of why operating rights have value and why this value grows, it is not a significant factor. In the view of analysts at the Chase Manhattan Bank: "[Operating rights] are an asset with unique and truly identifiable value which is unlike patents, goodwill or those values rising out of a merger or purchase, which may diminish in time." (Chase Manhattan Bank, *1976 Financial Analysis of the Motor Carrier Industry*, p. 10.)

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

portion of his own right to a third trucker who has similar problems. This trading in rights—if rational—will almost always increase trucking efficiency because the purchaser has a more profitable use for the right than the seller. The payments are thus, in part, payments to overcome the complex web of inefficiencies created by detailed ICC regulation of routes, commodities, and services. One trucker must pay another in order to serve the public interest.

There are thousands of operating rights, each of which fits into the jigsaw puzzle that truckers put together at considerable cost in the form of payments for the rights, as well as for legal fees and other items. After a while, transportation demands shift, the puzzle falls apart, and another must be constructed. This is a costly game, one that would not have to be played if there were more flexibility at the regulatory level. And, of course, it is the shipper, and ultimately the consumer, who pays the costs of the game.

It has been noted that the annual compounded rate at which an operating right grows in value diminishes with the length of time that the right has been held. This relationship suggests that the value of "old" rights reflects the decreased efficiency that occurs as frozen route structures become less suited to market demand. On a slightly different point, the behavior of the values of operating rights held for a short period of time suggests the possibility of sophisticated short-term speculation, a possibility that requires further examination.

Conclusion

The evidence we have examined suggests that the cost of shipping goods by regulated motor carriers is excessive, that truckers who are granted new operating rights receive large windfall profits, that those who purchase existing rights receive excess returns on them over time, and that large payments must be made to overcome route inflexibilities.

The value of an operating right is the capitalized value of the "excessive" returns it enables its owner to earn. In a sense, high truck rates (or, perhaps more accurately, regulation-induced monopoly power) lead to high values for operating rights, rather than operating rights creating the high rates or monopoly power. So long as the rate of return earned by regulated truckers consistently exceeds that which would exist in a competitive market, operating rights will retain value and may rise in value over time. Though rate-of-return considerations have been emphasized here, it is important to bear in mind that route inflexibility is a significant contributor to higher costs.

A recent task force report prepared by the staff of the ICC (see page 41, this issue, for a brief summary) makes special note of the high price of operating rights. The thrust of its brief discussion is that the high prices paid for rights look bad and that, perhaps, it would be desirable to put a "cap" on these prices or restrict in some manner the transfer of rights. One could infer that the ICC staff is, indeed, confused by the paradox we are trying to unravel. Placing a cap on sale prices or restricting the transfer of operating rights would lock operators into even greater inflexibility and result in ever higher costs of motor-carrier transportation.

Curiously, the commission seems not to have recognized that the aggregate value of operating rights is an excellent measure of the efficiency of its regulation. If operating rights command high prices, this is an indication that the commission is artificially constraining service, raising costs to consumers, and creating excess profits for owners of the rights. There should be little doubt that the paradox of valuable operating rights in a "competitive" industry can be explained by the existence of regulation that permits little real competition. ■

Selected References

Data on the value of operating rights and a discussion of the ICC's Bureau of Accounts memo to motor carriers can be found in American Trucking Associations, *Accounting for Motor Carrier Operating Rights* (1974).

For different analytical viewpoints on the effects of trucking regulation, see Thomas G. Moore, "Deregulating Surface Freight Transportation," in Almarin Phillips, ed., *Promoting Competition in Regulated Markets* (Washington, D.C.: Brookings Institution, 1975), the papers presented in Paul W. MacAvoy and John W. Snow, eds., *Regulation of Pricing and Entry in Truck Transportation,* Ford Administration Papers on Regulatory Reform (Washington, D.C.: American Enterprise Institute, 1977), and the first five articles summarized in Readings, this issue.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

In Search of OSHA

Philip J. Harter

SINCE its creation in 1970, the Occupational Safety and Health Administration (OSHA) has managed to alienate almost everyone. Employers find its regulations confusing and frequently unrelated to occupational safety or health, and its inspectors rude, arbitrary, and not conversant with the applicable regulations. The unions, arguing that the incidence of occupational disease and injury has not decreased since OSHA began operations, fault the agency for not promulgating the tough standards that would help to reduce the toll. *Business Week* has awarded OSHA the distinction of being the agency "hardest to live with," and members of Congress report more complaints about OSHA than about any other agency. OSHA even has internal troubles, reflected in low staff morale. Only the raconteurs are pleased—for the agency has provided them with a seemingly endless source of "OSHA stories," absurd examples of well-intentioned regulation gone amuck.

Much, if not all, of this dissatisfaction stems from a single source: OSHA's failure to develop an intellectually sound philosophy for its operations. Unless such a philosophy is developed, OSHA will continue to be *the* example of faulty government regulation and could face substantial statutory revision or even extinction.

The premise of this article is that there is now, as there was in 1970 when OSHA was established, a need for some sort of intervention to ensure that workers do not unduly subsidize industry with their personal safety and health. Though I recognize the importance of achieving efficient regulation in which marginal costs equal marginal benefits and recognize also the *theoretical* attractiveness of a regulatory program based exclusively on financial incentives, these matters are beyond the scope of this article. My purpose here is to explore some of the practical reasons for OSHA's problems in meeting its objectives through the use of mandatory standards. In my view, mandatory standards for occupational safety and health should not be abandoned simply because our first attempt with them has been so badly bungled: present difficulties could be avoided if there were sufficient determination on the part of the agency's policy-makers.

Philip J. Harter is senior staff attorney at the Administrative Conference of the United States. He served as co-chairman of President Ford's Task Force on the Occupational Safety and Health Administration.

The Beginnings

By way of background, the reported injury rate of American workers climbed sharply in the 1960s, making it evident to many that the diverse state safety programs, based on consultation and voluntary compliance with existing standards, were inadequate. Concern also developed about the adverse consequences of rapid technological change. Moreover, the economy was buoyant, which meant that Congress felt freer than it might have otherwise to create a new regulatory program that imposed costs on U.S. industry. Congress considered the question of how to regulate the work place for several years but most of the

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

debate, unfortunately, centered on the appropriate structure for setting and enforcing standards and for judging violations. Little attention was given to the hard questions necessary to establish a policy on which future standards could be based.

For this and other reasons, OSHA's problems begin with the act that created it, the Occupational Safety and Health Act of 1970. Congress wanted OSHA to start life on the run, so it required the agency to

> promulgate all national consensus standards and . . . established Federal standards unless [it] determines that a standard would not result in improved safety or health for all or some of the affected employees. . . . The purpose of this procedure is to establish as rapidly as possible national occupational safety and health standards with which industry is familiar [Senate Report 91-1282].

The agency thus spent its earliest days searching for standards, making "quick and dirty" determinations of whether they would increase safety in the work place, and hastily editing them into regulatory language. Most of the standards came from two sources: (1) the Walsh-Healy Act minimum requirements for firms that seek to do business with the government and, more important, (2) consensus standards that had been worked out over the years by industry standard-setting committees for industry's voluntary use.[1]

OSHA's editors converted consensus standards into mandatory safety rules by doing two things. First, the exhortatory "shoulds" were changed to "shalls" (indeed, a few "shoulds" escaped the editing), so that standards that were never intended to be mandatory were made so. The ladder standard, for example—covering twenty-two pages of fine print in the *Code of Federal Regulations*—was a manufacturing specification, not a safety regulation, and therefore contains much that is irrelevant to safety. Second, in many cases the editors simply cut out the words that defined the circumstances to which the standards applied, so that a standard that might have been perfectly appropriate in a limited situation was imposed across the board. This explains the OSHA regulation that solemnly prohibited employees from putting ice in drinking water. The industry standard from which that rule came was designed to keep workmen who were cutting ice on ponds from using that ice in their drinks because of the likelihood of contamination. With one sweep of a pen, a reasonable precaution was rendered ludicrous.

Perhaps OSHA could have been more careful than it was in deciding whether a standard would enhance safety. Certainly it would thereby have avoided some of its larger embarrassments. Perhaps, also, it could have been a little more careful in its editing. But the act directed that this work be done "as soon as practicable" and gave OSHA little flexibility to modify existing standards (though it did give the agency two years to adopt or reject existing standards). In any case, within six months of its creation, OSHA occupied an entire volume in the *Code of Federal Regulations* and hundreds of additional standards were incorporated by reference into the code.

Deficiencies in Standards and Approach

Deficient standards, along with some of the requirements of the Occupational Safety and Health Act, meant that the politics of OSHA's beginnings were very different from the norm. Usually the political momentum that moves a proposal for a new agency through the Congress spills over into the agency itself, so that its staff goes about the task of figuring out how to attack the problem at hand with youthful zeal. In OSHA's case, however, this zeal was spent on establishing a code that then had to be torn down and rebuilt. Like Sisyphus, the agency had to roll a rock uphill that promptly rolled back down on top of it. The adverse

[1]A "national consensus standard," as defined in Section 3(9) of the Occupational Safety and Health Act, is an "occupational safety and health standard . . . which has been adopted and promulgated by a nationally recognized standards-producing organization under procedures whereby . . . persons interested and affected by the scope or provisions of the standard have reached substantial agreement on its adoption [and which] was formulated in a manner which afforded an opportunity for diverse views to be considered."

Most of the consensus standards that OSHA adopted initially were developed under the auspices of the American National Standards Institute. That institute has revised most of the standards that form the basis of OSHA's regulation and has also developed new standards for situations covered in OSHA's code only by the general clauses.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

reactions of the business community to the standards—and to their administration at the hands of OSHA's officials—were translated into protests to Congress. This in turn rapidly chilled OSHA's already tepid support, making its task all the more difficult.

What are the major problems with OSHA's standards and its approach to regulation?

Four Levels of Regulation. One problem is that four separate levels of regulation are superimposed on each other. The first is the statutory general-duty clause of the 1970 act, which requires employers to provide a work place "free from recognized hazards that are causing or are likely to cause death or serious physical harm" to employees (Section 5). The second is a slightly more specific general clause applicable to a broad category of situations. For example, the clause covering machine guarding—the sixth most frequently cited OSHA regulation, from which stems 39 percent of all serious machinery violations—provides:

> One or more methods of machine guarding shall be provided to protect the operator and other employees in the machine area from hazards such as those created by point of operation, ingoing nip points, rotating parts, flying chips and sparks. Examples of guarding methods are—barrier guards, two-hand tripping devices, electronic safety devices, etc. [29 *Code of Federal Regulations* § 1910.212(a)].

This standard is general, performance-oriented and vague: terms like "such as," "examples," and "etc." indicate that only a partial list is provided, and no guidance is given on what must be done to comply. The third level of regulation concerns performance requirements applicable to a particular machine or situation.

The final level is the one most frequently complained of—the detailed specifications. They specify such things as the number of rivets required in a guard. They require, for example, that there must be a work-rest one-eighth inch from a grinding wheel, regardless of the size of the work-piece. (But when large pieces are being worked on, a work-rest that close to the wheel can interfere with the operation while not providing any more safety than a work-rest adjusted specifically for the task at hand. It should be noted in the last year alone, 6,400 citations were issued for violating this standard.) And a most famous example is the ladder standard, which includes such helpful details as the Latin names of the woods that are acceptable for constructing ladders and a requirement that extension ladders must be erected "so that the upper section is resting on the bottom section."

Gaps among the Minutiae. Because of the origin of its standards, many of the detailed standards that OSHA adopted were contrary to accepted industry practices at the time and some were hopelessly antiquated. Moreover, among all the minutiae and specificity, there were—and still are—significant gaps. This is especially true in the health area where there were no voluntary standards to be taken over. But it is also true in the safety area where the standards available for adoption neither specified details for nearly all of the operations that should be covered nor set forth broad policies—and certainly did not reflect a coherent philosophy.

For example, the section on machine guarding contains detailed standards on only seven different types of machines: woodworking, cooperage, abrasive wheels, mills and calendars in the rubber and plastics industries, mechanical power presses, forging, and mechanical power transmissions. In the opinion of professional safety engineers, these standards reach at most only 15 percent of the kinds of machines now in general use and are so narrowly drawn that a machine similar to one that is described in the regulation might not be covered by it. Machines not covered by a specific standard include printing presses, steel mills, metal cutting saws, compactors, shears, and conveyors. These and many others are governed only by the general-duty clauses. Neither the statutory general-duty clause nor the one generally applicable to machinery gives the employer, the employee, or the compliance officer guidance as to what is required. Moreover, even in those instances where the standards do cover a particular machine, the coverage may be inadequate. For example, although the safety of an abrasive wheel is critically dependent on the speed at which the wheel is operated, there is no standard limiting excessive speed. Finally, some outright contradictions appear in the detailed standards.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Congress was aware of the deficiencies in the existing standards when it required OSHA to adopt them. As Senate Report 91-1282 stated:

> . . . a large proportion of the voluntary standards are seriously out of date [and] many represent merely the lowest common denominator of acceptance by interested private groups. Accordingly, it is essential that such standards be constantly improved and replaced as new knowledge and techniques are developed. In addition, there are many occupational hazards—particularly those affecting health—which are not covered by any standards at all.

That is to say, Congress contemplated that OSHA would speedily revamp the standards. However, it burdened the agency with an organization and approach that did not make that task easy.

Diffusion of Responsibilities. The act creating OSHA assumes that, in general, the agency will consult with the National Advisory Committee on Occupational Safety and Health (NACOSH) about the administration of the act. If relations with NACOSH are to remain harmonious, the group must be kept apprised of major developments, especially if a major policy is to be adopted. Research for the establishment of standards, however, is not within the control of OSHA or NACOSH, nor even the Department of Labor. Rather it is conducted by the National Institute for Occupational Safety and Health (NIOSH), which is part of the Department of Health, Education, and Welfare. Once the research is completed, the assistant secretary of labor for occupational safety and health, who is OSHA's chief executive officer, may either appoint an ad hoc advisory committee to recommend a proposed standard or have the standard drafted within OSHA. Because of the structure of the Department of Labor, the lawyers who serve OSHA, and who are necessary to draft a standard, report not to the head of OSHA but to the solicitor of labor, who in turn reports directly to the secretary of labor. And because of the recent requirement for economic impact statements on new regulations, OSHA must also coordinate standards with the assistant secretary of labor for policy, evaluation, and research. Finally, when a citation for the violation of a standard is issued, a company may contest it in a proceeding before the Occupational Safety and Health Review Commission (OSHRC), an independent agency created by the Occupational Safety and Health Act.[2] While it is not the purpose of this commission to second-guess OSHA on the wisdom or philosophy of a particular standard, its interpretations of the statute and OSHA's standards can have important and unsettling effects on the final determination of policy. For example, OSHRC determined, contrary to the view of OSHA, that the term "feasible" (which limits the stringency of health standards) includes economic considerations and that a firm therefore need not comply with an OSHA requirement if it would be unduly costly to do so. Until the controversy over the meaning of the word "feasible" is resolved by the courts, OSHA's enforcement of that particular standard is made far more difficult than it was ever thought it would be.

To be sure, NIOSH has provided valuable information to OSHA, the Labor Department's lawyers have made up for some deficiencies within OSHA, and the separation of OSHRC from OSHA can be viewed as an embodiment of the Madisonian theory of separation of powers.[3] But given the normal tendency of government agencies to adopt their own schedules and priorities and to be unresponsive to other agencies, it is at best difficult for OSHA to generate the momentum necessary to adopt a new standard or change an existing one.

Problems of Compliance. Not only were many of the detailed standards seriously out of date, but some were inconsistent with other regulatory requirements. Under the regime of advisory consensus standards, companies could choose not to follow one that was technologically obsolete or in conflict with others—but no longer. On top of this, company managements have worried that if OSHA should revise its standards at an early date, they

[2] A citation includes both the allegation that the standard was violated and a proposed time period within which the company must correct the violation.

[3] One of the benefits that might be expected from a Madisonian separation of powers would be that the legislative side (OSHA) would issue clearly defined rules in order to limit the power of the judicial side (OSHRC). Madison was also aware that separation would cause inefficiency—an inefficiency that would protect us from despotism—but only that part of the theory has materialized thus far. (See *The Federalist*, nos. 48 and 51.)

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

would have to abandon investments made to meet the first batch of standards in order to comply with still newer obligations. And the standards themselves are often so technical that it is difficult for anyone other than a professional engineer to understand them even when the ultimate concept is relatively simple.

What is perhaps a more serious difficulty stems from the great number of situations for which there is no specific, applicable standard. In these instances, a company has difficulty in knowing whether it is complying with the law or what it should do to comply. Before investing large sums of money, many firms have wanted some sort of assurance that their efforts would meet with OSHA's approval. The natural inclination was to seek advice from OSHA on what must be done or on whether a proposed approach would be satisfactory. Unfortunately OSHA is statutorily prohibited from providing on-site consultation.

The agency came into being partly because of union dissatisfaction with state safety programs in which the relevant state agency would advise companies on how to meet their obligations. Charging that the follow-up on the advice was inadequate, the unions insisted that, with OSHA, each inspection of a work place must result in a citation if a violation was discovered. As a result, OSHA is not permitted to issue warnings or to provide specific advice on how to comply with its requirements, since if it were to consult with a company on its premises it might become aware of a violation and would be required to issue a citation.[4] To be sure, general advice is provided by OSHA (in off-site discussions) and by state programs, but the inability to secure firsthand advice has produced frustration and considerable friction between the business community and OSHA.

Another reason why firms have not made investments to comply with the standards is the low penalty for noncompliance. An employer who "willfully or repeatedly" violates the general-duty clause of the standards is subject to a $10,000 fine, but an employer who is guilty of a "serious" violation—one with a "substantial probability that death or serious physical harm could result"—is liable for a maximum fine of only $1,000. Curiously, the same $1,000 fine applies for a "non-serious" violation—though the imposition of any fine is discretionary for nonserious offenses but mandatory for serious ones. Indeed, in 30 percent of the citations for nonserious offenses no fine has been imposed, the employer being ordered only to bring his operations in line within a prescribed time. Overall, the average fine has been around $600 for a serious violation and around $25 for a nonserious violation. The small fines irritate businessmen while failing to provide any pressure for compliance.

Thus, a logical response for a company is to do nothing until coerced following an inspection—and the probability of being inspected is low indeed for any but the inherently dangerous operations. When the compliance officers appear, more problems arise. Many of them are ill equipped for the job, lacking either the training or necessary temperament. But even the best of them has an impossible task: If company managements cannot figure out what the standards require, how can the compliance officer do so when confronted with a new situation and required to make a quick judgment in any one of many technical disciplines? What are compliance officers to do when faced with a saw that is used to cut plastic or plywood and there is no standard applicable to either? Do they impose the standard applicable to saws used for woodworking, impose a consensus standard that was not adopted by OSHA, or try to figure out whether one of the vague general clauses might have been violated? If they choose the last option (whether for saws *or* something else), businesses complain heatedly that compliance officers are making up requirements right in the plant.

Making Haste Slowly

If these problems are so evident, why has nothing been done?

For reasons that may never be explained, Secretary of Labor James Hodgson did not appear to notice any shortcomings when the

[4] In partial response to the outcries resulting from the requirement that OSHA issue a citation whenever it became aware of a violation, Congress provided in OSHA's appropriations bill for the fiscal year 1977 that OSHA would be prohibited from issuing a citation for nonserious violations discovered during first inspections unless ten or more offenses were found.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

standards were promulgated in 1971. He proudly announced that the package was "both comprehensive and comprehensible." Less than a year later, however, in the President's Report on Occupational Safety and Health (May 1972), the secretary reported that a major effort was under way to revise and extend the safety standards. Indeed, OSHA had decided that revision had to be its highest priority—that it had to eliminate unreasonable specificity, put more emphasis on performance-based standards, and fill the gaps before new standards could be developed. Many changes were made. For the most part, however, they involved weeding out the absurdities—standards such as the prohibition on putting ice cubes in drinking water—and making minor editorial alterations.

Notwithstanding the congressional directive to update and revise the original standards, notwithstanding the bitter complaints from business and labor, and notwithstanding the agency's own announced intentions, the vast bulk of OSHA's current standards are still the original ones. In fact, no comprehensive revision has taken place and only a handful of standards (mainly for health) has been added. Those that were out of date in 1970 are more out of date now, and certainly the mere passage of time has done nothing to make them easier to understand or to extend their coverage to needed areas.

Of course, with suitable resolve, OSHA might have revised the standards and improved its administration. But the Occupational Safety and Health Act, as we have noted, creates a bias in favor of the original standards, and the organizational structure is a nightmare that makes any creative action difficult. Moreover, Congress provided no guidance on the revision or future promulgation of safety standards, and only sketchy and ambiguous criteria for the promulgation of health standards. In addition, the act complicates the task of revision by requiring not that the court review rules to determine whether the agency acted "arbitrarily or capriciously" (the normal requirement) but that judicial review must be based on the "substantial evidence test" (a standard that usually applies only to the review of adversary proceedings). This means that the agency must develop a strong factual basis for any change in a rule instead of predicating it on a simple change in policy. Finally, the act, like many new statutes, requires the agency to hold a hearing on a proposed standard if anyone requests it. Many believe that this requirement prolongs the regulation-development process and diminishes any momentum that has been built up for revision.

While each of these provisions may be a little unusual, they would not have to be inhibiting—if only OSHA had known where it was going and why. For example, OSHA expeditiously developed and promulgated a standard covering vinyl chloride when it became apparent that something must be done, and quickly. The rulemaking machinery can respond when necessary.

Perhaps the largest obstacle to reform is that it is always more difficult to revise a regulatory system than to build one from the ground up. When a program is being initiated, all interested parties can participate in the dialogue, and the agency will be able to explain why a particular approach best suits its needs. But when the agency wants to make a change, those who benefit from the status quo will defend it, arguing that change represents an abdication of responsibility to a competing interest group. This charge carries great political weight, because one of the parties is now losing something it already has rather than not getting something it seeks.

Steps toward Reform

Responding to intense criticism, OSHA has taken several steps toward comprehensive reform. On April 23, 1976, the agency published a notice in the *Federal Register* announcing "a new procedure to obtain data necessary for possible revision of certain standards regulating workplace safety hazards." The announcement requested public comment on several general matters that had to be considered, the agency said, in any comprehensive reform of its safety standards—matters such as how to simplify and clarify the standards, which standards are irrelevant to work-place safety, where coverage is incomplete, and what are the relative merits of performance or design standards. These matters are nearly identical to those OSHA had raised in its abortive effort at revision back in 1972.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Moreover, OSHA did not present any position or discussion of its own. Thus in its first leap forward, OSHA begged all the questions. And, as of August 1977, not one proposed revision has been issued.

Shortly after the April 1976 notice was published, President Ford created a task force to aid OSHA in its revision process. The task force developed a model for safety standards that could be used to increase safety in the work place while alleviating the difficulties inherent in the complex, detailed, but narrowly prescribed, current standards.[5] The approach taken by this model is to specify the types of hazards associated with the use of machinery and then to require all machines to be "installed, safeguarded, operated, and maintained at all times in a manner which protects all employees from traumatic injury or death resulting from the hazards enumerated." Should this approach be adopted, an employer would have flexibility in choosing which methods or what equipment to use to safeguard employees, but would be given an explicit and illustrative guide on *a way* to comply with the standard, should he or she desire to use it. OSHA requested public comment on the task force's approach, the first time since its birth that the agency had sought to establish a guiding philosophy for its safety regulation.

Late this spring (May 19), Secretary of Labor Ray Marshall and Assistant Secretary Eula Bingham announced a new policy for OSHA. The agency would concentrate, they said, on developing health standards and on eliminating the "needlessly detailed, complicated or unclear" safety standards—Secretary Marshall remarking (according to the *Washington Post*) that the "worst thing about wasting time and money on nitpicking regulations is that you shortchange the fight against the most serious dangers to human life and limb in high-risk workplaces." The response was immediate and highly positive. But the same theme had been stressed in each of the last five years by a succession of Labor Department officials—without result. More recently (August 5, 1977), the White House announced the formation of a new high-level task force to examine the feasibility of supplementing OSHA's mandatory safety standards with a regulatory system based on financial incentives.[6]

Concluding Remarks

Clearly, OSHA faces a monumental task if it is to reach its statutory goal of "assur[ing] so far as possible every working man and woman in the Nation safe and healthful working conditions." And, just as clearly, the agency will not be able to win the cooperation necessary to do this so long as its safety regulations are a source of irritation and ridicule throughout the United States. Only time will tell whether the Carter administration will follow through and make it possible for OSHA to do what it was set up to do. If there is follow-through, it might well be directed at solving the specific practical problems listed here. It is at least arguable that there is a baby (if not yet a very prepossessing one) in the bathwater and that we do not yet have to throw both of them out. ■

[5] For a detailed exposition of this model, see *OSHA Safety Regulation: Report of the Presidential Task Force*, Paul W. MacAvoy, ed., Ford Administration Papers on Regulatory Reform (Washington, D.C.: American Enterprise Institute, 1977).

[6] Apparently, the original concept was that this task force would find ways of *replacing* the safety standards with financial incentives. In response to objections from organized labor and Congress, the concept was changed to one of *supplementing* the standards with such incentives. (Compare *Wall Street Journal*, July 18, 1977, page 14, with the President's August 5 statement.)

Waterway User Charges

(continued from page 9)

tation mix. But they would also produce politically unpopular side effects, such as higher costs to ship by barge, resulting in higher prices for those goods. Both the Senate and the House have tried to minimize these, the Senate by stipulating that waterway user charges amount to no more than 1 percent of the value of the commodity shipment (including transportation charges), and the House by setting low user charges.

H.R. 8309 faces a serious floor fight—with opposition from the barge operators, who seek, at most, a token fuel tax, and from others, like the Carter administration, who have supported more substantial users' fees as the price of replacing Locks and Dam 26.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Readings
of particular interest

A Convenient Compendium

Regulation of Entry and Pricing in Truck Transportation, edited by Paul W. MacAvoy and John W. Snow (Ford Administration Papers on Regulatory Reform), American Enterprise Institute, 1977.

This collection of studies on motor-carrier regulation begins with an overview by John W. Snow, deputy undersecretary of transportation in the Ford administration and a member of the Domestic Council Review Group. He argues that motor-carrier regulation is needlessly complex and produces rates that are "high, inflexible, irrational, and discriminatory." Route regulation gives operating certificates a market value, which can only result from restrictions on entry. Rate regulation has led to identical rate structures for all shippers —whether they have balanced or unbalanced, stable or unstable, traffic—which can only reduce economic efficiency. Restrictions on the services that private and exempt carriers can offer results in needless waste, while certification of regulated carriers to serve small communities does not ensure that these communities are served.

In part two, an ICC cost/benefit analysis of surface transport regulation disagrees with conclusions published in 1971 by Thomas Gale Moore and presents estimates of substantial net benefits from regulation. This analysis is critically appraised by Bruce Allen of the University of Pennsylvania and Edward Hymson of the Department of Transportation, who argue that the ICC study suffers from "arithmetic errors and numerous unsupported assertions" and that it fails to distinguish between income transfers and net social benefits.

Part three deals with the probable effects of regulatory reform upon market structure, service to small communities, and the value of operating certificates. On the first, Richard Klem of the Department of Transportation argues that freer entry into the trucking market would reduce the incentive for end-to-end mergers that now leads to the formation of inefficiently large firms. On the second, R. L. Banks and Associates (consultants) suggest that carriers serving small communities succeed because they are themselves small and can offer specialized services that are uneconomic for larger carriers—and that, if anything, deregulation would improve small-community service. On the third, Snow and Stephen Sobotka (a transportation consultant) suggest ways of minimizing the impact of deregulation on current certificate-holders.

The fourth part discusses the impact of regulatory reform on energy use. Paul Roberts and James Kneafsey of MIT argue that rail traffic would be shifted to trucks, leading to increased use of energy, while Sobotka and Thomas Domencich (another consultant) conclude that this shift would not occur and that reform would improve trucking efficiency, thereby reducing energy use.

In part five, Norman Jones, now on the staff of the House Subcommittee on Economic Stabilization, analyzes proposals to eliminate backhaul restrictions (no loads on return trips) and "gateway" requirements (shipments from one regional authority to another must pass through certain "gateway" points, often requiring a circuitous route). He concludes that, without rate flexibility, the benefits of eliminating the restrictions would be small. Bruce Allen looks at the effect of expanding the Philadelphia Commercial Zone (the "commercial zone" of a city being that area in and around the city within which trucking is not ICC-regulated). In his view, expansion would improve operating efficiency for truck-load shipments.

Finally, agricultural economists Walter Miklius of the University of Hawaii and Kenneth Casavant of Washington State University examine the rates at which firms enter and leave agricultural trucking, which is exempt from ICC regulation, and conclude that the

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

exempt portion of the industry is as stable as the portion subject to ICC regulation.

ICC Staff Task Force Report

Improving Motor-Carrier Entry Regulation: Report and Recommendations of a Staff Task Force (George M. Chandler, chairman), Interstate Commerce Commission, July 6, 1977.

On June 2, 1977, ICC Chairman A. Daniel O'Neal established a staff task force to recommend ways for improving motor-carrier entry regulation. It was a response, as this report notes, to the "wide-spread feeling that there should be more competition in motor transportation" and to the "startling" increase that had occurred since October 1976 in applications for motor-carrier certificates. The report has thirty-nine recommendations, ranging from ways for providing easier entry into the regulated trucking industry to procedures for simplifying the operations of the ICC itself.

Addressing application proceedings first, the report recommends more rapid "summary grant procedures" for the 25 to 35 percent of motor-carrier applications that are unopposed, a new format for protests to weed out those that are essentially frivolous, the use of cost/price data in application cases, a procedure for identifying areas of insufficient competition, treatment of similar applications concurrently, and efforts to standardize commodity descriptions.

On the subject of easier entry provisions, the report recommends exempting from the Interstate Commerce Act those motor-carrier operations that are not "of major significance in carrying out the national transportation policy," exempting classes of transport rather than kinds of vehicles, expanding agricultural exemptions, deregulating additional commodities, limiting the rights of competing carriers to protest new entries, reducing the need for formal applications to serve new plant sites, removing restrictions on the transfer of cargoes between trucks and water carriers, encouraging intermodal transportation, establishing limited-use authorities for the carrying of government shipments, simplifying requirements for truckers who hold dual (contract and common-carrier) authority, giving blanket grants of temporary authority, and simplifying procedures for trucking brokers to enter the market.

The recommendations on internal ICC procedures include a number of proposals relating to the granting and hearing of appeals for temporary authorities without extensive procedures. Other recommendations include revision of truck-leasing regulations—with, as a first step, "a translation of the present regulations into English"—and a possible change of policy on operating authorities (1) to prevent truckers from selling these authorities for more than they originally paid for them, (2) to prohibit the sale of authorities without the sale of physical assets, and (3) to prohibit the sale of anything less than a trucker's full operating authority.

Finally, the report recommends a study of the independent trucker, the continuation of statistical analysis of applications for permanent authority, and a comprehensive study of motor-carrier entry.

Trucking in Northern Ontario

Transportation Rates and Economic Development in Northern Ontario by N.C. Bonsor, University of Toronto Press for the Ontario Economic Council (OEC Research Studies No. 7), Toronto, 1977.

The regulation of highway carriers by the Ontario Highway Transport Board is the worst of all possible systems, according to economist Norman C. Bonsor of Lakehead University (Thunder Bay, Ontario). Ontario's trucking rates are the second highest in Canada, and indeed Ontario's transportation rates are generally higher than those in any other province except Quebec. The study examines the impact of transportation costs on regional economic development, with special reference to northern Ontario.

Entry into the for-hire trucking industry in Ontario is controlled by the Ontario Highway Transport Board. To acquire a license for a specific route, the applicant must either purchase one from an existing carrier or convince the board that a new license would be consistent with "public necessity and convenience." At present, for all practical purposes the board limits licenses to the number already in use.

Bonsor shows that rail rates are inversely correlated with the degree of competition in

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

the trucking industry. Where a regulatory body such as the Ontario Highway Transport Board tightly controls entry to the industry, truck freight rates rise to artificially high levels and, because of the lack of competition, rail freight rates rise correspondingly. For example, Alberta's rail rates are lower than Ontario's because, in Alberta, the railroads must compete with truck carriers—who, in turn operate in the open, competitive Alberta trucking market. The relationship between high truck rates and high rail rates results partially from the fact that the Transportation Act of 1967 gives Canadian railroads considerable flexibility in adjusting their rates (except rates for carrying grain) to meet those set for truckers.

Small-volume shippers in northern Ontario are at a disadvantage because, owing to the lack of competition among and within different modes of transportation, they must ship at high "class rates." The rate structure stymies the development of secondary (that is, support) manufacturing, so that the region is likely to continue to be almost entirely resource-oriented.

As for what might be done, the "promotion of vigorous competition in the trucking industry is, from a practical viewpoint, easier to achieve than the enactment of a transportation subsidy designed to eliminate some of the transportation cost disadvantages of a Northern Ontario location."

Trucking in Europe

Trucking Regulation: Lessons from Europe by Thomas Gale Moore (AEI-Hoover Policy Study), American Enterprise Institute, 1976.

The author, senior fellow at the Hoover Institution, examines the experience of Great Britain (which in essence has abolished economic regulation of trucking), West Germany (where trucking is strictly regulated), Belgium (where considerable deregulation has taken place), the Netherlands (which has less regulation than West Germany but more than the other countries considered), and Sweden (where partial deregulation has occurred). The examination is based to a great extent on interviews that the author carried out in late 1973 and in early 1974.

Moore notes the difficulty of isolating the effects of trucking regulation in the five countries, attributing this partly to the different regulatory approaches these countries use. For example, Sweden and Belgium regulate entry by requiring proof of ability and character, while the Netherlands requires competitive examinations to the same end, and the West German government limits the number of trucking licenses as well as requiring proof of ability and character. But these differences appear less important than differences in national character—a conclusion that the author did not anticipate. He finds that British firms really do seem to "muddle through," while German and Dutch managements are painstaking and precise in their operations. There are also differences in the geographical characteristics of the countries considered. For example, West Germany needs considerable long-haul trucking, the Netherlands needs almost none, while Sweden has a large, sparsely inhabited northland.

However, Moore says, all five countries are at least in northern Europe and are roughly comparable. Moreover, Great Britain and West Germany on the one hand, and Belgium and the Netherlands on the other, provide excellent pairs for comparison. In each case, the more heavily regulated of the two countries being compared (1) provides monopoly profits to the carriers enjoying certification, and (2) has a far higher percentage of truck miles run empty. In West Germany, 66 percent of all miles driven by own-account carriers (that is, carriers transporting their own goods) were driven empty, while in Great Britain the figure was 30 percent.

In West Germany regulation has apparently not succeeded in its original purpose, which was to protect or promote railroad freight service. But in the Netherlands, where the purpose was to stabilize the market shares of truck and rail carriage, it has succeeded, though at some cost. No certain conclusions can be drawn on the relationship between regulation and optimum firm size. Nor is it clear whether larger firms are more efficient than smaller firms.

In general, the lessons Moore draws—preeminently from the West German case—are that regulation increases costs to shippers and discourages service to small and out-of-the-way communities. On this evidence, he recom-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

mends deregulation of the U.S. motor-carrier industry.

Earlier Research Flawed?

"Minimum Rate Regulation, Modal Split Sensitivities, and the Railroad Problem" by Kenneth D. Boyer, in *Journal of Political Economy*, June 1977.

"The story that minimum rate regulation is responsible, partly or largely, for the mid-twentieth-century decline of the American railroads has an established place in the folklore of academic economics." By establishing minimum rail rates that are too high, so the story goes, the ICC has prompted shippers to switch their business from railroads to trucks. Kenneth D. Boyer of Michigan State University disagrees with this explanation. To understand why, it is necessary to look at the traditional, comparative-cost approach to analyzing competition between trains and trucks.

Much previous research has found that the long-run marginal costs of shipping by rail are less than those of shipping by truck, even after rail shipment costs are adjusted upward to reflect the fact that rail transport is slower, less reliable, and less flexible than road transport. The fact that shippers have switched from rail to road nonetheless is attributed to the ICC's setting minimum rates for rail transport higher than the adjusted long-run marginal cost of rail carriage.

Boyer argues that these earlier analyses are seriously flawed by underestimates of the size of the adjustment factor that is needed to reflect accurately the differences in the quality of train and truck services. In fact, because this adjustment has been so seriously underestimated, earlier measures of the economic loss from traffic misallocation (that is, from rail to truck) overestimate the true economic loss by a factor of twenty. Traffic shifted from the railroads to the truckers because of superior truck service and not because of ICC rate regulation.

Boyer concludes that deregulation of minimum rail rates would have "only a small effect on the intermodal traffic allocation" and that the social gains would be much smaller than many have predicted.

The Rising Tide

Government Controls and the Public Interest: An International Survey of Business Opinion and Experience by Michael Duerr and James Greene (Information Bulletin No. 21, Conference Board, June 1977).

"The rising tide in government controls over business is reaching the danger level in many parts of the world," according to the Conference Board's 1977 survey of business leaders in thirty-three countries. The executives "are nearly unanimous in deploring the trend toward government controls"—despite their general agreement on the need for government intervention in the economy. Many state that regulation, having moved past the stage of irritating business, is now at a level that hurts the very citizens it is supposed to help. Overall, the report says, this survey reflects a noticeably "grimmer" view of government's role in business than did a similar Conference Board survey done ten years ago.

Responses indicate that in many cases it is the manner, rather than the fact, of government intervention that is taken amiss. There is strong concern about the uncertainties and inefficiencies caused by government controls, about the effects of the government's increasing share of GNP, and about anti-business attitudes of legislators who recognize that businesses do not cast votes. In general, the interviewees agreed that the government actions most needed "are programs that would stimulate rather than discourage private investment."

The consensus is that, short of a crisis which turns public opinion against government intervention, the rise in controls can only be reversed by government initiative.

An Analysis of Safety Regulation

"Safety Regulation" by Nina W. Cornell, Roger G. Noll, and Barry Weingast in Henry Owen and Charles Schultze, eds., *Setting National Priorities: The Next Ten Years* (Washington, D.C.: The Brookings Institution, 1976).

Safety regulation—its rationale and its practice—is analyzed in this study by Nina Cornell of the Council of Economic Advisers and Roger Noll and Barry Weingast of the California In-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

stitute of Technology. Their analysis of why private market transactions will produce insufficient safety forms the context for assessing the performance of two federal agencies concerned with safety issues, the Consumer Product Safety Commission and the Occupational Safety and Health Administration.

Federal safety regulation presumably reflects a judgment that, in its absence, sufficient preventive measures are not taken to provide the level of safety that people would be willing to pay for as consumers and workers. The basis for this judgment is examined by analyzing the safety levels that would emerge in a purely private market system. If information on hazards were complete and costless, decisions by consumers and workers would result in prices and wages that would exactly compensate for the risks they chose to assume and fully reflect the costs of preventive measures. But when the development and dissemination of information on hazards is costly, a completely private economy will provide too little information. In addition, the authors note that complicated and technical information is not easily translated into practical conclusions, particularly when the risks are uncertain.

Liability laws and insurance systems contribute to higher safety levels by creating incentives to take preventive measures; moreover, they can contribute to a more equitable sharing of losses. The limitations of liability laws result mainly from uncertainty about causes of damage and from compensation that does not in general match losses. Similarly, insurance systems do not create proper incentives for preventive measures if there is too much uncertainty to permit appropriate premium levels to be set.

For these and other reasons discussed by the authors, the market system together with liability laws and insurance systems does not ensure that enough attention and resources are devoted to preventive measures or that the costs of damages and losses are dealt with efficiently and equitably. Consequently, regulation by setting standards is warranted, particularly when information that serves as a basis for decisions is complex and costly and when the nature of the hazard and the chances that losses will occur are highly uncertain.

Turning to an examination of safety regulation as practiced by the Consumer Product Safety Commission and the Occupational Safety and Health Administration, the authors observe that information development and dissemination receives too little emphasis, that the establishment of priorities has been unsatisfactory, and that both standards development and compliance and enforcement activities are subject to criticism on various grounds. They note, however, that the emphasis and approaches of these agencies have apparently been strongly influenced by congressional attitudes and actions. One major problem is the assumptions underlying the legislation: that "well-defined clear-cut hazards" are the essence of the safety problem, that with "brief, cursory investigation" remedies can be identified, and that "'bad acts' by unethical businessmen" are the principal cause of inadequate product and occupational safety. Safety regulatory agencies have tended as a result to "focus on issues to which they have least to contribute."

Cornell, Noll, and Weingast recommend more reliance on information strategies by the safety regulatory agencies. Congress should shift the focus of their regulatory activities toward problems the market is least able to solve, such as health hazards that are complex and only partly understood, and toward more use of incentives to induce compliance. The authors conclude that, while safety regulatory agency practices "are not designed to deal effectively with the very types of cases in which standards are appropriate," there are, nonetheless, occasions "when efficient government intervention in the form of standard setting regulation is called for."

Labor Criticizes OSHA

"OSHA: The Urgency of Revival" by Russ Bargmann, in *The AFL-CIO American Federationist*, June 1977.

Russ Bargmann, a research associate of the AFL-CIO, maintains that "Nixon-Ford mismanagement," reliance on state-administered plans, inadequate resources, procedural logjams, and industry pressures have prevented the Occupational Safety and Health Administration from realizing its full potential. There is, consequently, an urgent need for reform.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

According to Bargmann, OSHA acts too slowly and the standards it adopts are often inadequate. Thus, there were only five occupational health standards in force as of May 1977—those five covering asbestos, thirteen carcinogens, vinyl chloride, coke-oven emissions, and benzene—and they were established only after concerted effort by the unions. Also, OSHA's recently proposed standard on cotton dust accepts worker exposure up to a level at which 13 percent of all exposed workers become ill.

The requirement for economic impact analyses of proposed regulations contributes to OSHA's ineffectiveness by causing delay and subjecting proposed standards to the Council on Wage and Price Stability's disregard of "positive health effects." Bargmann argues that cost estimates "fail to consider all the beneficial aspects of health and safety standards," such as gains in worker efficiency as well as the lower product prices that can result from reduced workers' compensation premiums.

Inspection and compliance procedures also contribute to ineffectiveness. Bargmann notes that at the 1976 rate of 41,000 *new* inspections (out of a total of 76,600 inspections), it will take OSHA 100 years to survey all the nation's work places. As for compliance, when firms are cited for violations, the case often drags on for years before the Occupational Safety and Health Review Commission and the courts, while the hazardous conditions continue unchanged. Because the expenditures required to improve safety conditions are generally much higher than fines assessed (which average $11.94 for minor violations and $544.94 for serious violations), many employers find it "cost-effective" to pay the fines and "flout the law."

Addressing the businessman's complaint that the cost of compliance could lead to bankruptcies, Bargmann makes these points, among others: (1) the OSHA order to cut down the exposure of rubber workers to airborne carcinogen vinyl chloride has forced no companies out of business, despite dire predictions to the contrary; (2) an analysis by the American Foundryman's Society found no instance where OSHA alone was responsible for the closing of a foundry; (3) the fact that business capital expenditures for health and safety equipment increased less than inflation in the 1972-1975 period indicates that OSHA has not overburdened employers.

Cancer and the Environment

"Contribution of the Environment to Cancer Incidence: An Epidemiologic Exercise" by Ernst L. Wynder and Gio B. Gori, in *Journal of the National Cancer Institute,* April 1977.

"With the increasing number of news reports regarding hazardous components, the average citizen considers himself immersed in an uncontrollable sea of carcinogens." But, according to this guest editorial, it is individual lifestyles, including excessive smoking, alcohol consumption and "overnutrition," that are the major environmental factors contributing to the incidence of cancer.

Physician Ernst L. Wynder of the American Health Foundation and microbiologist Gio B. Gori of the National Cancer Institute review the epidemiologic literature based on intercountry and intracountry differences, incidence differences between men and women, and time trends, and conclude that 90 percent of the cases of human cancer can be ascribed to environmental factors—that is, to factors "originating wholly or largely outside the host's body." The remaining 10 percent of the cases are considered the "baseline," meaning they are the number of cases attributed to genetic, viral, and radiation factors.

The authors conclude that the most significant environmental factors are tobacco use and nutrition. Epidemiological evidence for the contribution of tobacco use to the development of cancer is overwhelming. For example, lung cancer rates for populations such as the Seventh Day Adventists who are nearly all nonsmokers are more than 80 percent lower than the rates for the U.S. population in general. And, although "specific carcinogens play a minimal role in the relationship between nutrition and the development of cancer . . . nutritional deficiencies and/or excesses are of great importance as sources of procarcinogens. . . ."

Less significant but often-cited carcinogenic factors are air-and-water pollution, occupational exposure, and perhaps drugs (here the evidence is sketchy). According to Wynder and Gori, studies that control for smoking and

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

the other factors that contribute to lung cancer find no significant relationship between cancer and air-and-water pollution; further research is needed. There is no question, however, that certain occupational exposures (asbestos and uranium dust, for example) increase the risk of particular cancers. Various estimates put the occupational contribution to total cancer incidence between 1 percent and 5 percent for males and between 1 percent and 10 percent for the general population.

Finally, comparisons of morbidity and mortality rates for different countries indicate that most cancers are related to individual lifestyles. Nevertheless, people tend to ignore their own responsibilities and lay the blame on carcinogenic exposure from outside forces. The authors conclude that although society must make every effort to correct those general environmental factors that contribute to cancer incidence, self-regulated individuals can significantly limit their own risks by appropriately altering their own lifestyles.

Regulation and Hospital Costs

"The High Cost of Hospitals—and What to Do about It" by Martin Feldstein, in *The Public Interest,* Summer 1977.

From 1950 to 1976, the average cost per patient-day for hospital care rose by more than 1,000 percent, eight times the rise in the consumer price index. Economist Martin Feldstein of Harvard University regards this exorbitant inflation in hospital costs as the "central problem of our national health-care policy."

The author finds the four "traditional" explanations of increasing costs—hospital inefficiency, increases in labor costs, poor technical progress, hospital supply not meeting demand—to be incorrect. The true explanation is that increased insurance has induced hospitals to upgrade their product by providing more sophisticated, more expensive care. As Feldstein explains it, private and government health insurance now pays so much more of the hospital bill than it did twenty-five years ago—88 percent in 1975, up from 49 percent in 1950—that in *real* terms the cost to the patient at the time of illness has not increased at all. This situation had made expensive forms of medical care attractive to physicians, administrators and patients, and the hospitals have responded by providing it.

Feldstein identifies the tax treatment of health insurance premiums—which permits individuals and employers to deduct their respective costs for health coverage from taxable income—as a major reason for the growth of private health insurance and a significant contributor to the underlying problem of excessive insurance.

Public-utility-type regulation of hospital costs, currently under consideration in Congress (see "Containing Hospital Costs," in *Regulation,* July/August), demonstrated its weaknesses during the Economic Stabilization Program of 1971–1974. Limits on increases in wages and fees for service "were constantly being confounded" by rapid increases in the quality or sophistication, and therefore the price, of services and eventually had to be replaced by limits on the increase in the cost per patient-day. The American Hospital Association then filed suit against the Cost of Living Council on the grounds that its mandate did not include regulation of the quality of hospital care, an issue that became moot when the stabilization program expired.

Public-utility regulation is inappropriate for containing hospital costs, according to Feldstein, because (1) there is no "technically correct" way to set standards on the maximum quality of care, (2) the only limits on health-care quality that patients will tolerate are those they set for themselves, and (3) regulation that requires all hospitals to have the same quality of care would force many families to pay for more expensive care than they wished to have and would deny many others the opportunity to purchase the higher quality care they would prefer.

The solution, in the author's view, is to provide every family with comprehensive major-risk insurance that eliminates coverage for relatively inexpensive health care and gives complete coverage for major care (unlike many insurance plans now). This plan would make families "sensitive to the costs of additional health spending while still limiting each family's maximum out-of-pocket expenditures to 10 percent of income or less." The program would be administratively simple, bypassing the tedium of regulation that other plans for national health insurance would entail, and

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

would increase government spending by only $19 billion over the 1976 level.

Milking the Consumer

"The Cost of the U.S. Dairy Price Support Program: 1949-1974," by Dale Heien, *Review of Economics and Statistics*, February 1977, pp. 1-8.

The federal government supports the incomes of dairy farmers in a variety of ways, the main ones being the milk price support program (which mostly involves purchases of milk products by the Commodity Credit Corporation) and the federal milk marketing order system (which allows dairy cooperatives to set minimum prices for fluid-grade milk). Federal expenditures for CCC purchases of dairy products, notes Dale Heien, a private consultant in Washington, D.C., totalled $7 billion during the 1949-1973 period. In addition to this burden borne by the taxpayer, another burden—that of the increased costs of dairy products at the supermarket—was shouldered by consumers. This study estimates the 1949-1974 impact *on consumers* of the price support program and of the federal milk-marketing order system.

Heien obtains his estimates by constructing an econometric model of the U.S. dairy industry which contains twenty behavioral equations, twelve identities, and fifty-six variables. He divides the model into three sectors to deal with retail demand, retail price formation, and farm output and price determination.

To compute the cost to consumers of federal dairy price suport programs during the twenty-five year period, the author compared differences in solutions based on his model. First, all variables were given their actual historical values. For comparison with this baseline solution, it was assumed that no dairy products had been removed from the market by Commodity Credit Corporation purchases—that is, it was assumed that no CCC purchases had been made. Comparison of the consumer price indexes implied by the two solutions permitted Heien to estimate the market cost of the price support programs to the consumer at $3.4 billion for the 1949-1974 period, or an average of $131 million a year. A similar exercise designed to measure the impact of the federal milk-marketing order system produced an estimate of $4.6 billion as the cost to the consumer from that system during 1949-1974, or an average annual cost of $175 million.

Standards and Industry Self-Regulation

"Standards and Industry Self-Regulation" by Ernest S. Rosenberg, in *California Management Review*, Fall 1976 (also in R. N. Katz, ed., *Protecting Consumer Interests: Private Initiative and Public Response*, Ballinger, 1977).

Standards—defined here as conditions and requirements governing commerce between buyers and sellers—have an enormous impact on society and the economy. Ernest S. Rosenberg—formerly on the staff of the Federal Trade Commission and now with the Environmental Protection Agency—says there are over 20,000 industry standards and 36,000 government standards in effect in the United States, and more than 400 organizations are at work developing these standards. The National Bureau of Standards (NBS) of the Department of Commerce carries out research but has no regulatory authority, while the American National Standards Institute (ANSI), a private body—albeit with governmental members—acts as a standards clearinghouse.

Rosenberg argues that the process of developing and certifying standards should serve the useful purposes of facilitating commerce, reducing prices, and increasing the safety and quality of products and services without impeding competition or innovation. But sometimes the process leads instead to abuses, ranging from consumer deception to restraint of trade.

The difficulty lies in the process. Proposed standards are drafted by experts and, although they are then reviewed by interested parties and not approved until a consensus has been reached, they are generally so technical that deficiencies can go undetected at the approval stage. Normally, the source of the deficiencies is not industry venality, but rather the fact that the proposal drafters cannot see problems from all perspectives and rarely consider the overall economic and social-welfare effects of what they are doing. Thus, accord-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

ing to Rosenberg, the solution is to open up the drafting process to consumer and policy viewpoints.

The author discusses the four major types of standards, noting the benefits and dangers of each. Standard definitions, nomenclature, and classifications are needed to facilitate communication, but may lead to hidebound thinking (lack of innovation) and consumer confusion (when comparable products have widely differing classifications). Standard methods of testing enable comparisons between products, but result in faulty data if test designs are deficient. Performance specifications present the fewest problems, the major one being that minimum performance standards may be set too high or too low. Lastly, design or construction specifications are the most restrictive. Because they tell manufacturers not only what performance level must be met, but also how to meet it, they tend to freeze technology, deter R&D, and preclude competition.

In Rosenberg's view, "the key to reforming standards is somehow to monitor and police the first stage of drafting" without having "the government supplant the voluntary standards-writing organizations." He recommends (1) giving the proposed agency for consumer advocacy the power to represent the consumer in standards-setting processes; (2) making the National Bureau of Standards into an independent agency with research, coordination, and monitoring responsibilities; (3) bringing the functions of the American National Standards Institute largely under government control to ensure conformity with NBS criteria; and (4) forming a Bureau of Standards Review within the FTC to advise the NBS.

More on Self-Regulation: Lawyers

"The Evolving Concept of Professional Responsibility" by Thomas D. Morgan, in *Harvard Law Review*, February 1977.

Not all regulation comes in the form of active government intervention. Sometimes it comes, instead, in the form of government ratification of, or acquiescence in, self-regulation—which is the case with the state bar associations' regulation of the legal profession.

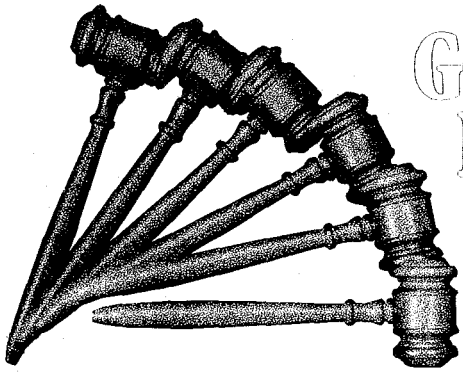
As law professor Thomas D. Morgan of the University of Illinois points out, the public interest in justice, the private interest in legal advice at reasonable cost, and the lawyers' personal interest in a rewarding livelihood are all affected by the role of the private bar. Morgan considers whether the public interest and the private interest are served by the self-regulation accomplished through the Code of Professional Responsibility of the American Bar Association. He concludes that, to a great extent, the ABA's code promotes the interests of lawyers over those of the larger public and at the expense of the interests of clients.

To be sure, there are complex issues at stake, not the least of which is the problem that lay clients have in attempting to assess the professional competence of lawyers. Morgan finds the code gives clients little help in this matter when it unnecessarily requires the use of lawyers to handle matters like real estate contracts, debt collection, and uncontested divorce and probate cases, but does not require special expertise of lawyers' offering services like tax counseling and representation before specialized agencies. This problem is magnified in that the private bar (with state ratification of the code) creates monopolies for lawyers in areas where nonlawyers might serve equally well. Another problem is that the code rarely requires lawyers to maintain a higher standard of ethics than the law in general requires. For instance, it admonishes them not to communicate outside of court with jurors or to counsel clients to break the law. A third problem is that the code's restriction on advertising by lawyers inhibits price competition for legal services.

The basic difficulty with the code is not so much that lawyers intentionally drafted a self-serving document, but rather that they made no provision for interested nonlegal parties to participate in the drafting. Thus, even issues containing potential conflicts between lawyers and clients or lawyers and the public interest were decided by lawyers. Over time this procedure allowed biases to develop.

Morgan foresees substantial changes to make the legal profession more responsible, the major ones being an end to the bar's monopoly of legal services, increased solicitude for client interests occasioned by increased competition through such devices as advertising, and the use of malpractice suits against lawyers.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED



GOVERNMENT REGULATION

TOO MUCH OR NOT ENOUGH?

SELECTED AEI PUBLICATIONS ON GOVERNMENT REGULATION

Public Policy Forums

COMPETITION IN THE AIRLINES, Albert V. Casey, Edwin I. Colodny, Edward M. Kennedy, Lamar Muse, John Robson, with John Charles Daly, moderator *(43 pages/$2.00)*

U.S. ENERGY POLICY, Melvin R. Laird, Edward J. Mitchell, John F. O'Leary, Morris K. Udall, with John Charles Daly, moderator *(45 pages/$2.00)*

THE SACCHARIN BAN: RISKS VS. BENEFITS, Sherwin Gardner, James G. Martin, Frank J. Rauscher, Sidney Wolfe, with John Charles Daly, moderator *(42 pages/$2.00)*

U.S. FARM POLICY: WHAT DIRECTION? Thomas S. Foley, Paul Findley, Clayton K. Yeutter, John A. Schnittker, with John Charles Daly, moderator *(40 pages/$2.00)*

PRO SPORTS: SHOULD THE GOVERNMENT INTERVENE? Jack Kemp, Lee MacPhail, Ed Garvey, Roger Noll, with John Charles Daly, moderator *(42 pages/$2.00)*

NATIONAL ECONOMIC PLANNING: RIGHT OR WRONG FOR THE U.S.? Clarence J. Brown, Hubert H. Humphrey, Wassily Leontief, and Herbert Stein, with John Charles Daly, moderator *(51 pages/$2.00)*

REGULATION OF POLITICAL CAMPAIGNS: HOW SUCCESSFUL? Eugene J. McCarthy, John B. Anderson, Ralph K. Winter, Jr., and Fred Wertheimer, with Lawrence E. Spivak, moderator *(60 pages/$2.00)*

ADVERTISING AND THE PUBLIC INTEREST, Joan Z. Bernstein, Robert H. Bork, Tom Dillon, and Benjamin Rosenthal, with John Charles Daly, moderator *(40 pages/$2.00)*

REFORMING FEDERAL DRUG REGULATION, Michael J. Halberstam, William N. Hubbard, Jr., Louis Lasagna, Gaylord Nelson, and Alexander M. Schmidt, with Jules Bergman, moderator *(40 pages/$2.00)*

GOVERNMENT REGULATION: WHAT KIND OF REFORM? Hubert H. Humphrey, Ronald Reagan, Hendrik Houthakker, and Ralph Nader, with Eileen Shanahan, moderator *(60 pages/$2.00)*

Ford Administration Papers on Regulatory Reform

This special AEI series, edited by Paul W. MacAvoy, makes available basic documentary information from task force reports, study papers, and memoranda on issues in government regulation.

OSHA SAFETY REGULATION: Report of the Presidential Task Force
Outlines a model for improving the safety regulations of the Occupational Safety and Health Administration. This model, which emphasizes performance-based standards instead of specification-based standards, is designed to increase safety in the work place while reducing the complexity of regulation. *(104 pages/$3.25)*

REGULATION OF ENTRY AND PRICING IN TRUCK TRANSPORTATION
Contains background analyses and research on the major issues involved in reforming ICC regulation of the trucking industry. *(301 pages/$5.75)*

FEDERAL ENERGY ADMINISTRATION REGULATION: Report of the Presidential Task Force
Finds that the costs of FEA regulation of the petroleum industry outweigh the benefits and offers recommendations to simplify and improve regulation during periods of normal supply and during shortages. *(194 pages/$3.75)*

REGULATION OF PASSENGER FARES AND COMPETITION AMONG THE AIRLINES
Examines issues involved in proposals for reducing economic regulation of the airlines in order to achieve lower-cost and more efficient commercial air service through increased price and route competition (co-editor John W. Snow). *(169 pages/$4.75)*

DEREGULATION OF CABLE TELEVISION
Discusses the adequacy of existing information about the effects upon consumers of current anticompetitive cable-TV regulation, and considers the degree to which available information supports proposals for relaxing FCC restrictions on cable-TV's use of broadcast signals. *(169 pages/$3.75)*

FEDERAL-STATE REGULATION OF THE PRICING AND MARKETING OF INSURANCE
Examines the role of state regulation of insurance rates and raises questions about the need for a special antitrust exemption. The report also contains the Department of Justice proposal that would permit insurers to choose between state regulation as currently practiced and a more flexible national system. *(105 pages/$3.25)*

Forthcoming later this year:
Publications on regulatory reform in the railroad industry and the regulation of milk pricing and marketing.

The AEI Associates Program offers participants copies of all AEI publications at a saving. For more information, write AEI.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

American Enterprise Institute
for Public Policy Research
1150 Seventeenth Street, N.W.
Washington, D.C. 20036
(202) 296-5616

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED